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Anna Faelten
London, October 2016

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Preface

Mergers and acquisitions (M&A) continues to be a prominent tool for advancing or changing the strategic agendas of companies of all sizes around the world. Despite its popularity with corporate executives, deals continue to struggle to live up to expectations in terms of long-term value created. The **Introduction** (Faelten, Driessen and Moeller; 2016; Why deals fail: And how to rescue them; *The Economist*) chapter of this chapter deals with this point, addressing the questions of why deals fail and how to rescue a deal which is showing early signs of failing. The chapter covers a number of well-known (completed and non-completed) deals, including HP's acquisition of Autonomy, the Microsoft and Yahoo tie-up that never materialised and the Glazer family's successful pursuit of Manchester United, over the course of the last decade which are used as case studies to illustrate points dealmakers often get wrong during the deal process. The conclusions made in this chapter shows that there are three main areas which dealmakers get wrong most often and which are seen to be potentially most value destroying for deals, being a lack of focus on planning, people and communication.

A significant driver of M&A activity over the last decade has been global companies investing in emerging or developing countries by acquiring existing local businesses. This strategy has obvious benefits in acquiring an existing team, customers, distribution channels, etc., but also knowledge about ways of doing business in the local market and knowledge about culture and potential differences with the acquiring business. It is often seen as a quicker and more efficient entry strategy compare to a greenfield investment. However challenges are also several and includes unknowns and uncertainty around the legal, political, economic, financial and structural environment. Chapter 1 and 2 explore these challenges and possible factors which can mitigate these risks. **Chapter 1** (Appadu, Faelten, Moeller and Vitkova; 2016; 'Assessing market attractiveness for mergers and acquisitions: the M&A Attractiveness Index Score', *European Journal of Finance*) builds on work by Rossi and Volpin (2004) and presents a new scoring methodology designed to measure a country's capability to attract and sustain business investment activity in the forms of cross-border inflow and domestic mergers and acquisitions (M&A). The index and its components serve as the determinant(s) of M&A activity and it is shown that the type and significance of various aspects of a country's environment differs significantly at different stages of country maturity.

Another important element of M&A activity and the success of the same is corporate governance. Building on the scoring methodology and the index presented in the previous chapter, **Chapter 2** (Faelten, Gietzmann and Vitkova; 2013; 'Naked M&A transactions: How the lack of local expertise in cross-border deals can negatively affect acquirer performance – and how informed institutional investors can mitigate this effect'; *Journal of Business, Finance and Accounting*) explores how the composition and experience of a company's board can help acquirers succeed with acquisitions in foreign markets. The chapter builds on theoretical and empirical work around financial geography including Dye and Sridhar (2002) and Ferreira, Massa and Matos (2009) and tests the hypothesis that deals in which long-term investors have a high level of expertise in the target firm's region are more likely to perform better than if the deal is 'naked', i.e. when such regional expertise amongst the investors is low. The evidence presented confirms the hypothesis and also demonstrates that is strongest when the maturity for corporate transactions (see Chapter 1) of the target country is low.

The subsequent two chapters, Chapter 3 and 4, contributes to the literature by researching the link between a company's decisions to access capital markets and subsequent M&A activity. Since the early 1990s, when Ritter (1991) first documented the aftermarket underperformance of IPOs, there has been a significant number of papers published confirming his results across markets and geographies. **Chapter 3** (Appadu, Faelten and Levis; 2013; 'Acquisitions, SEOs, Divestitures and IPO Performance'; Chapter 17 in 'The Handbook of Research on IPOs') contributes to the literature by

empirically testing the link between the IPOs and subsequent corporate event activity. Importantly, the empirical results also show that such characteristics of corporate events have a defining effect on the aftermarket performance of IPO companies.

The final **chapter 4** (Appadu, Faelten and Levis; 'Reverse Takeovers: Are they a Viable Alternative to IPOs?') examines a unique dataset of Reverse Takeovers (RTOs) – a corporate event which includes a privately listed entity acquiring a publically listed entity and the merged entity lists as a result of the transaction - in the UK from 1995 and 2012 and compare them with a matched sample of IPOs. RTOs, particularly the US listings, have seen a significant amount of documented issues highlighted, both around poor quality of foreign listings but also due to widespread underperformance of the listed entities in the years following completion and the entities' low survival rates (Gleason et al., 2005 and Adjei et al., 2008). The chapter concludes that due to the similar regulatory framework between IPOs and RTOs in the UK, there is no significant difference in follow-on event activity and aftermarket performance between the two types of IPOs and RTOs, leading to the elevation of RTOs as a viable alternative to IPOs.

0. Why Deals Fail: And how to rescue them

Anna Faelten, Michel Driessen and Scott Moeller

A note on terminology:
There are numerous words describing deal-making, such as transaction, acquisition, takeover, investment, deal and merger. The most important distinction is arguably between a merger and an acquisition. The technical definition of the difference –as it happens a non-standardised and debated one - is a topic outside of the scope of this book. That said, in general, a merger is a combination of two similarly-sized, often larger, leading companies in the same industry that creates a new, larger company, whereas an acquisition is typically a bigger company buying out the shareholders of a smaller one, to then integrating it within its own structure. Many practitioners use these terms interchangeably, but we have tried to be careful in making the above distinctions between mergers and acquisitions.

0.1. Introduction

The Three Big Mistakes of Deal-Making

When Silicon Valley heavyweight Hewlett Packard [HP] sealed a takeover of Britain's Autonomy in 2011, no one predicted the corporate car crash that would follow.

There had been very few significant deals since the 2008 global financial collapse and economic slowdown, which helped HP's CEO Leo Apotheker to secure a reasonably upbeat reception when he made his bold statement to transform the sleepy IT company into "a leader in the evolving information economy."

But just 12 months later, HP had lost its reputation and its chief executive and was facing write-downs of $8.8 billion, nearly 80 per cent of the $11 billion it paid for Autonomy. Worse, in 2012, HP alleged that it had been the victim of fraud by Autonomy's management and its auditors, blaming the losses on "serious accounting improprieties, disclosure failures, and outright misrepresentations."

Autonomy and its founders have, as you would expect, publicly and categorically rejected such claims. HP, on the other hand, has agreed to pay one of its shareholders, PGGM Vermogensbeheer, a Dutch pension fund, $100 million in damages, without admitting any liability.

The company was and is facing years of legal battles. Irrespective of their outcome, the takeover will go down in history as a spectacular failure.

High Expectations

Founded in a garage in Palo Alto in 1939, HP was one of the original core Silicon Valley start-ups and later it was the world's largest manufacturer of computers.

But as the industry developed, the company found itself stuck in the low-end margin business of computer hardware production and despite its hefty $95 billion market capitalization, HP's share price was suffering as a result.

Figure 0.1-A: HP’s share price – February 2009 to December 2013

Under pressure from investors to improve its strategic positioning, the company brought in Leo Apotheker as its CEO in November 2010, with the strong expectation of immediate acquisitions. Apotheker was an experienced executive in the computer industry, having spent over 20 years with the multinational German software company SAP, and just prior to his appointment, at HP, as SAP’s co-CEO.

A tie-up with Autonomy, a British entrepreneurial success story, looked like the solution to a faster and more innovative future growth. The company, a Cambridge University spin-off, was founded in 1996. By the time of HP's bid, Autonomy was in the FTSE 100. On August 18, 2011, HP announced a formal offer of £25.50 ($42.11) per share, a 64 per cent premium on the previous day's closing price.

Headed by Dr. Mike Lynch, a Cambridge University engineer who started out building the technology behind music synthesizers, Autonomy was one of the fastest-growing and dynamic software businesses in the world. Its main product, the IDOL (Intelligent Data Operating Layer) platform, was ground-breaking and is still marketed by HP as a highly intelligent tool for indexing unstructured data.

In the year of the deal, Autonomy posted record quarterly revenues of $256 million. However, some analysts questioned not only the value of Autonomy’s technology but also its accounting methods.

Richard Windsor, formerly at Nomura Securities, commented on HP’s challenges to Autonomy’s accounting practices: "Autonomy's detractors have been writing about this for years and there has been the occasional obvious sign that things were not quite right. The most common red flag was that cash flow in some quarters often did not match profit. This is quite unusual in a software company.”

“It is certainly noteworthy that HP acquired Autonomy at a record price tag, only to write down most of the price paid less than two years later, blaming the huge write off on the very accounting practices which industry experts and analysts had been questioning for years."

Whatever the legitimacy of these accounting practices, any such issues should have been dealt with at the all-important due diligence stages – both pre-announcement and pre-completion.

The Transaction and its Aftermath

On the day of the announcement Apotheker proudly told investors: "HP is taking bold, transformative steps to position the company as a leader in the evolving information economy. Today's announced plan will allow HP to drive creation of long-term shareholder value."

The decision to buy your way onto a new strategic path is common practice, but there are certainly a number of alternatives to outright M&A which perhaps would have been better and less risky for HP. Deciding on the right target company to acquire to reach your strategic aim is also a tricky task. Later in this book we highlight the need to have a 'live' target list where you track your most desired assets closely. Sealing a deal means finding both the company that is the right strategic fit but which is also potentially 'in play', that is, where a deal with the existing shareholders is even possible. It is certainly possible that HP suffered from a fixation on its target, Autonomy, a common error for buyers, which means they had already lost a significant amount of bargaining power when negotiating the final price paid.

Although HP's share price rose by 15 per cent in the wake of the announcement, reflecting an initial positive reaction by the investment community, it closed the day as the US market's worst performer. The new strategy, as laid out by management, was apparently not credible to HP's shareholders when they analysed it.

Analysts and investors challenged the ability of HP to integrate the combined business - perhaps remembering HP's challenges with its 2001 merger with Compaq - and the company faced an uphill battle to convince its various stakeholders that this large bet was a good one. As we will demonstrate, effective communication on the day of the deal's announcement is crucial, as it is management's chance to position the strategy and value behind the deal and to align the views of internal (who have known about the deal perhaps for as long as several months) and external stakeholders (who only find out about the deal with the public announcement).

Things quickly went from bad to worse for HP. Just weeks later, Apotheker was fired and replaced with Meg Whitman, previously CEO of eBay. Then, in May 2012 after a mere eight months with HP, Lynch - who was a crucial part of the Autonomy takeover - left, taking much of Autonomy's remaining management team with him.

Many cited a clear culture clash between the corporate bureaucracy of HP and the more entrepreneurial, flat-structured Autonomy. As we will discuss throughout this book, a failure to recognize cultural differences between the buyer and target - effectively choosing to ignore the human component of any deal - is one of the most oft-cited reason for M&A failure.

These days – but also at the time of the HP / Autonomy deal -- the due diligence process done rightly includes a comprehensive segment on culture. We will highlight later in the book the importance of that cultural fit, demonstrating that cultural compatibility or potential differences must be raised early in the deal conception phase, ideally well before any public announcements and especially if people are a key component of profitability, as was the case with Autonomy.

The departure of Lynch and his team was only the opening sequence of a very long blame game leading, as mentioned earlier, to the now infamous $8.8 billion write-down announcement in November 2012.

Responding to allegations of fraud, Lynch replied in an open letter: "As we have said before, we believe the problem with the Autonomy acquisition by HP lies in the mismanagement of that business by HP under its ownership, making it impossible for Autonomy to deliver on HP's expectations. Autonomy's accounts were fully audited by Deloitte throughout the period in question and Deloitte has confirmed that it conducted its audit work in full compliance with regulation and professional standards. We refuse to be a scapegoat for HP's own failings."

Sadly, the HP and Autonomy story is far from unique. RBS's acquisition together with Fortis and Banco Santander of ABN AMRO also crosses the line between the merely misguided and downright disastrous.

In this book, we will use these and many other examples of both famous global companies and smaller, less well-known firms to demonstrate how much value has been destroyed by ill-considered or poorly executed M&A deals - and how that could have been avoided. As we will show, there are a number of errors which deal-makers appear to get wrong on a consistent basis, a common and recurring set of mistakes if you will. As presented throughout this book, we have summarised these in a list of tips and guidelines, intended to help buyers and sellers to avoid the usual pitfalls and therefore preserve value throughout the deal process.

Our assessment of these deals is, by necessity, an analysis of their impact only in the broad period following the deals. For example, following the UK Government's inevitable re-flotation of RBS, the bank it bailed out during the 2008 financial crisis, it is conceivable - if unlikely - that events as yet unknown could propel RBS to the top of global banking's profitability league in, say, fifteen to twenty years' time after the deal with ABN Amro. But should that happen, none of the credit will belong to the men and women who executed the deal in 2007.

Introducing The Big Three

There were several manifest failures in the HP-Autonomy deal, exhibited as well in many of the deals we discuss in this book. But we have distilled them to three overarching issues - failure of planning, failure of communication and failure to properly consider the impact of people - which we believe are the *Three Big Mistakes of Deal-Making*.

1) Planning

This supposedly transformational acquisition of Autonomy was by its nature inherently risky, even for HP, a company valued at nearly $100 billion. The cost of Autonomy was sizeable at $11 billion. Its importance for HP was magnified because the company was pinning its future on the transaction to deliver strategic wins in terms of culture change in the core business as well as cross-selling and its own market position.

If you don't have a clear, detailed, well-thought out and articulated deal strategy, no planning for its integration will be sufficient: the two are inherently linked. Planning also entails being prepared for any pushback from the regulators, an increasingly important issue for corporate deal-makers due, among other factors, to the rise in cross-border acquisitions globally.

While large transformational deals are not automatically destined for failure, perhaps a more gradual shift towards high-end software products, buying smaller, more easily digestible targets, would have worked better for HP. Hubris is one of the most common M&A pitfalls for business leaders who are prone either to over-estimate their own ability or under-estimate the scale of the task.

2) Communication

HP's failure to communicate convincingly the benefits of the deal to its shareholders, as demonstrated by the significant fall in share price on the day of the announcement, was the start of the downfall for the transaction.

Effective communication is often the reflection of a well prepared and well aligned combined management team; the case for synergies should be clearly articulated in the due diligence phase and the 100 days integration plan written by the time the deal is announced.

Knowing that in any deal there are significant risks, it was certainly appropriate for investors and analysts, for example, to ask questions about the price HP paid for Autonomy.

The deal did, as stated, represent a significant premium on Autonomy's share price, implying that HP expected to generate synergies from the deal worth, as suggested by several analysts at the time, a minimum of $2.9 billion on a net present value basis. Add to that the fact that HP was paying 24 times the trailing Earnings before Interest, Tax and Depreciation [EBITDA], and most analysts would say that the price was a stretch. And this figure does not include costs associated with transaction such as advisor fees and integration costs, which were likely another 15-20 per cent of the deal's price at a minimum.

HP saw the transaction as the facilitator of a significant strategic shift towards high-end software and indeed as a tool to change the culture of its traditional core business. But when a buyer is attracted to a target because of its culture, an understanding of the specific components that make this culture so unique is pivotal to making the deal work. HP might have admired Autonomy's culture, but it did not truly understand it nor how or even whether it could be adopted by HP's other divisions.

3) People

Poor communication and a lack of understanding of the culture of Autonomy led to the third failure to appreciate, evaluate and consider the value of people. Autonomy's culture was what HP said it wanted, yet it failed to lock in and learn from its expensively acquired new management team and its different, more entrepreneurial culture.

In summary, HP failed in all three areas, even though a failure in just one of the Big Three could have been sufficient to make the deal fail overall. Generally speaking it is necessary to be successful in all three but certain deals may require a focus in one area more than another.

We will discuss the significant difference between valuation and pricing in M&A in later, but the high price paid in this case implied that HP knowingly paid a premium over Autonomy's pre-deal market valuation. HP must have seen real strategic businessvalue in Autonomy as well as its culture and management team, aspects that are difficult to assign a financial value to. They would have also assumed significant post deal synergies, helping to justify the price paid. In hindsight, it is quite clear that those synergies were overstated or the estimated risk of delivering the same was understated.

As the management team of Autonomy pointed out following HP's court filing disclosures in September 2014, HP's own estimated revenue synergies of $7.4bn as a result of the two businesses operating as a combined was certainly a hefty target and, they claimed, the real reason behind the significant write-down. In their own court filings, HP, on the other hand, pushed the argument of misstated underlying revenues which had led them to believe Autonomy had more potential – and value to them – than was actually the case. The correct valuation is the result of sound and achievable financial forecasts based on accurate and well-researched due diligence data, none of which appeared to have been present in this particular deal.

Readers may be surprised that although we reference price and value here, we do not categorise it as one of our Three Big Mistakes.

Whilst we do consider pricing to be a significant potential concern, we do not believe mis-pricing is terminal. Firstly, there is no such thing as the 'one right price' in an M&A context. What the buyer ultimate pays for the target is based on its own views regarding the financial future value of the target including the potential synergies as a result of the two businesses combining and any changes that the buyer may make post-deal. Clearly, the inputs into a financial model to determine the value will be different from bidder to bidder and those are ultimately different from the sellers' view who see their company on a stand-alone basis. The difference here is what creates the opportunity to transact

a deal. So the price paid will be incorrect for anyone but the buyer that closes the deal. The highest bidder will usually – but not always – prevail and even though a full price was paid, it can be deemed a success if the underlying predictions are correct.

Secondly, determination of the price paid as 'right' can only be done with the benefit of hindsight. There are a plethora of other factors which can destroy value for the acquirer. We have seen many deals where the pricing was certainly considered as full and the buyer was able to achieve its aims despite this; in fact mis-pricing in this context - where a price was paid well above market expectations - is the one major error companies can actually recover from. That said, appropriate pricing, meaning NOT overpaying, does make success easier to achieve.

Few M&A transactions collapse as dramatically as HP's takeover of Autonomy, but a far greater proportion do fall far short of their promise to deliver on the expected value creation.

Numerous studies from the 1980s and 1990s show a failure rate as high as 70-80 per cent. But it is getting better. The best-case scenario in more recent studies is a success rate of just under 50 per cent, as noted earlier. Given the opportunities for value destruction of such a significant corporate event, a 50/50 hit rate is hardly satisfactory.

The broader implications are highly significant. Mergers and acquisitions are part of the fabric of economic life. They help drive a significant proportion of corporate growth, whether in large, mature companies or recent start-ups. In fact, globally somewhere between 25,000 and 35,000 M&A deals are completed annually. They are not a rare phenomenon.

According to one study, the chance of a Fortune 1000 company being involved in a merger or acquisition in any given year is close to 30 per cent. Of all the companies that have been listed on the UK stock exchange since 1995, our own research indicated 25 per cent announced an acquisition within 12 months of listing. By their second year that rises to 41 per cent and by the third year, more than 50 per cent. M&A deals are here to stay.

M&A is, we believe, one of the most fascinating activities in the business world. However, corporates more often than not get them wrong. We have purposefully avoided a bias towards coverage of only private or only public deals as we believe the mistakes that are often made are the same for either type of deal.

For obvious reasons of data availability and familiarity, the case studies used in this book are often of larger deals including household names. But there is no reason to believe that the lessons learnt from those transactions are not applicable to smaller deals between mid-sized or small businesses. In deals between smaller companies and private deals, albeit often less process driven as you are likely to have less headache in dealing with regulators and a large and diverse shareholder base, you are quite often dealing with founder-owned businesses who, rightly, are very emotionally attached to the businesses they have built. Navigating the politics and dynamics between negotiations (when the parties are very much on opposite sides) at the same time as you are devising a combined business plan and organization structure (when the same parties have to start working together) is the key element in making sure the deal gets over the line. Deal-makers often say: "A small deal is as complicated and painful as large one." Simple deals just don't exist.

As well, the whole M&A process can be very scary, even for experience dealmakers. As Sebastian James, head of technology retailer Dixon Carphone said to Management Today after the merger of Carphone Warehouse and Dixons in 2014, 'My terror was that when we combined the two, we'd get that 80s nightmare where they bred African killer bees with European docile honeybees. You hoped for loads of honey with a nice temperament but you could have wound up with a load of angry bees and not much [of the runny stuff] to show for it.'

And although almost all the examples in this book are corporate case studies, there are also obvious lessons that can be learned for those doing deals in the public sector, such as the merging of governmental agencies, or the Third Sector, including the consolidation trend for many charities and hospital trusts.

These are lessons to be learned that will be useful for both seasoned deal-makers and newer participants. The statistics speaks for themselves: there is no guarantee you will get this deal right even if you succeeded with earlier ones. For new practitioners, this book will take you through the full deal process, from strategic groundwork to doing the right deal, all the way to how to avoid a corporate divorce, and what to do if one is inevitable. In fact, one part of this book is dedicated entirely to the topic of divestitures. For those more experienced deal makers, a reminder of the do's and don'ts should always come in handy.

Finally, as the three authors are located in Europe we have a natural bias to use case studies where at least one party is European, but that doesn't mean that we don't also use deals from North America and elsewhere. We all have first-hand experience in deal-making worldwide and can testify that the mistakes made are applicable on a global scale. It is probably one of the few areas where culture doesn't differentiate behaviour.

0.2. Think Before You Buy

Getting to the top of the corporate ladder puts a bulls-eye on your back …. not just for as long as you can keep that job but even afterwards, as CEOs and other senior managers of some failed M&A deals have found out to their chagrin and both their reputation and financial loss. In many jurisdictions, shareholders can file lawsuits against companies and individuals many years after the deals have closed.

CEOs who make the wrong strategic gamble, as HP's Leo Apotheker did, are summarily shot. There is rightly huge pressure on corporate leaders, commensurate with their often huge remuneration packages, to be seen to deliver quick solutions for their companies. But rushed deals can also lead to reputations being destroyed forever, as we will show in our discussion of Royal Bank of Scotland's former chief executive Fred Goodwin.

The key phrase above is "to be seen to". We will set out the strategic options open to new CEOs when they take office. But some of these options grab far more attention than the others. CEOs don't tend be selected as the cover story of Forbes or Fortune magaines for achieving years of steady incremental organic growth. But many have appeared on the cover after initiating a transformational merger.

In addition to the high expectations of shareholders, employees, lenders and the press, CEOs who like to do dynamic things are self-selecting. And few corporate decisions are as 'dynamic' as an M&A deal.

In the case of HP, Apotheker was hired not because he was content to do small things, but because he had already been the CEO of SAP, where he had risen up the food chain, in part, because of his big, differentiated vision for the company and indeed its role in defining the entire information technology [IT] sector.

Properly directed, such dynamism can unlock great value for companies and their shareholders through M&A. Unchecked, such dynamic ambition can tip over into the sort of hubris that drove Goodwin toward the decisions that practically destroyed his company when he bought ABN AMRO.

What's Your Facebook Relationship Status?

One of the most successful companies of the last decade and one that, as we will see, has shown it knows when to do M&A - and when not to - is Facebook, the social media network co-founded by Harvard student Mark Zuckerberg. Started in his college dormitory, the company grew phenomenally with revenues of $12.5 billion at its 10 year anniversary. Nicely, Facebook's online guide to social status easily translates into our guide to corporate deal-making.

Facebook allow users to select their relationship status for all their friends to see. The options are:

- Single
- It's complicated
- Open Relationship
- Divorced
- Separated
- Widowed
- In a relationship
- Engaged
- Married
- In a Domestic Partnership
- Civil Union

To adapt these options to the corporate world, we need to trim the number down to five options, all of which have a business corollary that any company can consider in its strategic review.

So:

- 'Single', becomes: Do nothing, remain independent and focus on organic growth
- 'It's complicated': Buying minority stakes in other companies or preparing for one of the other four options
- 'Open relationship': Strategic alliances/ joint ventures [JVs]
- 'Divorced': demergers/ divestments of assets/ liquidation of an unprofitable division or one that is no longer strategically necessary, or in the process of trying to sell a division ('separated')
- 'In a relationship' is the start of the process that the that leads to formal announcement of an acquisition or merger ('engaged') or having done so ('married', 'in a domestic partnership', 'civil union')

We consider each of these strategic options in turn, but before we begin it is important stress how little time incoming CEOs may have to make an impact. Bob Kelly, former CEO and Chairman of Bank of New York Mellon, was abruptly pushed out by his board following a near five-year tenure during which he implemented, then pretty much seamlessly integrated, a widely-applauded transformational merger between Bank of New York and Mellon Financial.

The 2011 press release announcing his departure did not provide much detail about his removal, stating simply that it was "due to differences in approach to managing the company" between Kelly and the board of directors.

Inevitably there were underlying causes: some observed that there were cultural differences between Kelly and some of his executives and there was also the release of information related to Kelly's decision to pursue publicly a bigger job at Bank of America.

But strip aside any 'blame' and there is a factor Kelly had in common with many departing executives which is that he had been in the post for around five years when he left.

The average tenure of a Fortune 100 CEO is approximately 4.6 years. In fact, Kelly used this statistic to answer a question posed to him at a Cass Business School conference about why he chose to

make the huge decision to merge with Bank of New York in 2007 after just nine months in post as CEO and Chairman of Mellon Financial.

The reality is that public company boards and institutional shareholders do not have the same generation-long horizons as, say, some investors such as Warren Buffett, and even shorter than the 5-year standard private equity investment timeframe.

For founder or privately-owned high-growth businesses, there usually comes a time when the size of the underlying business means year-on-year growth slows and M&A becomes an important tool to stay ahead of competition. It is often a strategy used before the company itself is sold and thereby demonstrates as well that management can execute deals, a feature which is attractive for later potential buyers and especially for a private equity buyer who wants to have a quick and simple deal.

Figure 0.2-A: Corporate status overview

Status:	Company growth:	Market position:	Market dynamics:	Action:
Single	Strong	Niche, Protected	Medium to Strong	Focus on organic growth
It's complicated	Low to Strong	Focused	Low to Medium	Buying minority stakes in other companies
Open relationship	Low to Strong	Focused	Medium to Strong	Strategic alliances/ joint ventures
Divorced	Low to Medium	Diversified	Low to Medium	Demerge / Divest assets / Liquidate unprofitable division
In a relationship	Low to Strong	Expanding	Medium to Strong	Focus on M&A

CEO companies must decide on their strategy as quickly as possible to have the best hope of reaping the benefits of transaction integration within their corporate life-time. But what about the alternatives to M&A? There are a number of different options, often less risky but equally effective, which are available to CEOs, as discussed below.

Staying Single

The first option a CEO should consider is doing nothing, at least not externally do a big M&A deal, and instead just focus on organic growth. In wider society a 'single' Facebook status can carry the taint of social pariah, particularly, one suspects, for the social network's fickle teenage audience.

In the corporate world, however, there are three types of singleton: 1) the desperate one who is either a seller but finding it hard to attract a suitor or a buyer who simply can't find a target at an affordable price, 2) the catch at the top of the business hierarchy who can afford to take their time to pick and choose between many admirers and targets, and 3) the fundamentally single committed corporate bachelors, as many of the new 'unicorn' (valuation over $1 billion) private companies in the Fintech world and many smaller, often family-owned businesses, who prefer the independence of being 'single'. Over a company's lifetime, it might fall into more than one of these categories at different times.

For a company that only came into being in 2004, Facebook has spent most of its life in the corporate marriage business. Over its relatively short lifetime, Facebook has surprisingly made more than 50 minor add-on acquisitions in its first dozen years, as well as some major ones. These were designed to keep things fresh for their crucial teenage audience, and included deals with new social media platforms Instagram and WhatsApp.

But so far as being a target goes, Facebook has been adamant in retaining its 'single' status, even when surrounded by large admirers.

After News Corp bought the MySpace social networking site in 2005, Facebook became the Prom Queen of a tech sector mesmerised by the corporate marriage business. The company was caught up in a bidding war with several major players, including News Corp, approaching it about a takeover. In 2006, Facebook began formal talks with Yahoo, whose own strategy was in disarray and who was a deeply eager groom. Yahoo offered $1.4 billion for Facebook, a fortune for its founder Mark Zuckerberg who had co-created the social networking platform as part of a "Would You Rather?" college jape just a few years previously.

So exponential has Facebook's growth been since then, it's easy to forget that at that time the reach of its platform was limited to just university campuses and then high schools in English-speaking countries, principally the US.

Even so, Zuckerberg was not to be diverted from his vision by Yahoo. Talks broke down and within a year Facebook would receive a $240 million cash injection from Microsoft that allowed him to keep control of the business (and which made the Microsoft / Facebook relationship status 'it's complicated'). The Facebook co-founder hit pay-dirt in 2012 when the company's flotation catapulted his personal net worth to $28 billion, all thanks to his determination to stay corporately single at a crucial time.

In holding out for his vision, Zuckerberg was following in the footsteps of another tech sector great: Steve Jobs, according to American website Business Insider.

In the late 1990s, Apple was on the verge of bankruptcy. The company had been losing money for 12 years, so it was no great surprise that in 1997, Chief Executive Gil Amelio was shown the door as the company welcomed back its co-founder, Steve Jobs, who commenced a turnaround which arguably could be the greatest corporate comeback of all-time.

The company Jobs had co-created had lost focus and was spending money it didn't have on projects that were unlikely to bear fruition.

Once a competitor to Microsoft and IBM, Apple had lost the personal computer war. But while Apple still viewed Microsoft and IBM as the enemy, co-founder Jobs saw things differently. Instead of selling the company for what would probably have been the equivalent of a corporate pittance, he helped to engineer an emergency $150 million cash injection from Microsoft, who ironically did not want to lose Apple because it believed the US Government would come down harder on its own dominant position in software if it were to lose yet another competitor.

Once that lifeline was secured, Jobs began a root and branch reform of Apple. At an early meeting he reportedly told the board: "You know what's wrong with this company? The products SUCK. There's no sex in them!"

Soon the iMac, the first "non-beige box" computer, was born. Apple sold nearly 800,000 units within five months of launch and by 1998 the company was back in the black. A marketing revolution followed as the iPod, iTunes and finally the iPhone, products with which the old enemy Microsoft had no hope of competing, changed the personal computing market forever.

We can see from these examples that timing is everything when it comes to making a decision about whether to stay single.

When considering whether to merge or buy, sectoral trends can be crucial, whether rivals are consolidating rapidly or whether they are breaking down and de-merging. But there may also be overriding company-specific issues, as there were with Facebook. In that case, Zuckerberg was one of the few people in the world who could see his company had a prime-mover advantage in a truly new industry, so rightly held out as a singleton.

Just because everyone is involved in M&A, doesn't mean your company should be. 'Single' status doesn't have to be bad, as we've shown above, and it is certainly preferred to being 'married' to the wrong partner.

RBS's 2007 bid for Dutch bank ABN Amro made sense in terms of rapid sector consolidation and as a defensive move against a rival bid by RBS's competitor Barclays Bank. But it did not make sense for RBS, which was already over-leveraged, to chase ABN Amro just as the global economy began to unwind, particularly after ABN Amro completed the lock-up sale of its US arm LaSalle Bank, supposedly the big prize coveted by the UK bank.

Equally the converse might be true. The previous wave of UK banking sector consolidation in the 1990s saw the creation of a very successful Lloyds TSB from the merger of the two high street banks. The spate of deals also provided Fred Goodwin, RBS' CEO at the time, with his greatest triumph in the swift acquisition and integration of rival NatWest. That corporate marriage made sense; the next one didn't.

Outside of these consolidation trends, there are a small band of businesses for whom it is always appropriate to stay away from the large, transformational deals. There aren't many of them and it is hard to define these committed bachelors and maidens, since they are not limited to any particular industry or part of the world. In fact the essence of their corporate personality is that very ability to stay independent in a rapidly globalising world.

A few examples can be found in industries that have already consolidated so deeply that governments and regulators will protect the status quo to ensure they do not become any more concentrated. An example of this is accountancy where, after the collapse of Arthur Andersen made the Big Five a Big Four, regulators have made clear they would save any of the remaining four in the public interest should they hit an Enron-type scandal and that mergers among the Big Four will be blocked. Even though this is the case all four accountancy Firms have been active in making smaller, bolt-on or complementary/ adjacent acquisitions (eg. PwC buying consultant Booz & Co or Deloitte similarly buying Monitor). Other examples can be found in heavily regulated industries such as mobile and land-line telephone companies and in electric and gas utilities companies. As noted earlier, family-owned business often fall into this category, too.

But most of our "committed bachelors" are able to stay independent because they have a strategy of providing very niche premium products with a global reach such as the strategy consultancies like McKinsey, Bain and BCG and certain corporate law firms, as discussed below. Often, they provide premium services particularly in professional services, an over-represented business among this group.

In the future, increased globalisation, new technology, political revolutions or just the passage of time might force these businesses to adapt. But for the moment, they are single because they can be. And they glory in it.

One such firm is New York-based Wachtell, Lipton, Rosen & Katz. For a business whose work is advising on mergers it represents an anomaly: as resolute a bachelor as exists. So are the firm's leaders ignoring the industry they serve, or is something else going on?

By any metric, Wachtell is successful as a standalone law firm. Founded on a handshake by the four principals and Jerry Kern in 1965, its name has been associated with M&A deals for decades. Watchtell even invented the much-copied poison pill, a hostile defense technique that as we discuss later in this book.

Wachtell's strategy appears to work as it has been one of America's most profitable corporate law firms since lawyers started keeping a public record on performance, with . Pprofits per partner of $5million according to the American Lawyer published in 2014, making it the US' most profitable

law firm by some margin. In the same year the firm was the third most active M&A advisor globally, working on 70 deals worth $308 billion, including Halliburton's acquisition of Baker Hughes for $36.4 billion and the merger of Tim Hortons and Burger King Worldwide, a deal worth $11.4 billion. It is easy to see why it would you wouldn't want or need to merge with anyone.

Other exceptional law firms have also managed to occupy the same high ground.

In London, Slaughter and May is known as the firm who refused to globalize, or to accept branding developments at a time when its rivals rushed towards globalization, stealing ideas from other, less traditional, professional service industries along the way.

For any other law firm, this refusal to move with the times would have sounded its death knell or it would simply have been absorbed into a larger consolidator.

The secret to Slaughter and May's success is that advises more of the UK's FTSE 100 and 250 than any of its rivals, giving it an in-built advantage over the competition.

As other firms rushed to find international partners, lawyers at the firm saw the cultures of their rivals being diluted and decided that, as long they didn't have to, they didn't need to merge.

As result of this vote for independence - or if you look at it another way, in spite of it - the firm has consistently been the most profitable among major European law firms. It has managed to keep its top-notch client base and perhaps most importantly for those who control the business, its culture.

These two corporate law firms are not the only ones who have stayed independent. There are many other professional services firms and family-owned businesses - small, medium and large - who have stayed independent and have been highly successful, mainly because they hold a strong niche position in their industry or just within their own geography. Timpson, the UK-wide shoe repair company, is an excellent example of just such a family-owned business.

Committed bachelors and maidens may be admirable high achievers, but singledom is not a reasonable ambition for most companies. The forces of globalization have been driving business towards a 'bigger is better' model for decades, and will continue to do so.

So, the more likely scenario is that CEOs will at some point look externally to find growth, innovation or industry consolidation synergies. However, there are three alternative Facebook status options that could result in the same outcome – all outlined below - and which should always be considered first as they are arguably less risky than full 'marriage'.

It's Complicated

In the corporate world, we believe that "it's complicated" is analogous to the taking of minority stakes in other companies. As in the world of personal social relationships, this sort of arrangement is increasingly widespread, but slightly murky in that the longer-term purpose of stake-building is often not readily apparent.

In some industries, such as biotechnology and software development, taking minority stakes is an established corporate practice, and in others, such as the convergence of banking and technology, it is an emerging, but popular and maybe even necessary, trend. In this sense the corporate world has entered the sphere of venture capitalists en-masse, creating seed funds to bankroll start-ups and stakes in emerging players. As with strategic investments in technology start-ups, this is often a form of outsourced R&D for the larger firms.

In the life sciences industry GlaxoSmithKline spun out a group of scientists and patents involved in experimental drugs for analgesics in 2010. GSK kept 18 per cent of the new business, called Con-

vergence Pharmaceuticals. In this case the deal was seemingly designed to cut overheads in research and development for GSK, boost productivity at the new company and still leave GSK with "skin in the game."

The spin-off was part of wider trend: Big Pharma is facing patent expiry on valuable products and many in the industry have responded to investors' concerns by outsourcing clinical service and research to smaller, more agile and entrepreneurial firms. Similarly Baxalta spun out Baxter, its haemophilia treatment division, in 2014; so successful was the spin-off, that Baxalta became the target of a successful $32 billion takeover by Shire Plc just 12 months later.

In 2014, business publisher Euromoney teamed up with Carlyle, the private equity house, to buy out data provider Dealogic for $700 million; Euromoney took a 15.5 per cent stake. Here the motivation was less clear. There are some synergies between Dealogic and Euromoney and the publisher could, in the longer term, be planning to buy out Dealogic and move it completely into its stable of titles. On the other hand, it could be a purely financial investment. Because 'it's complicated,' nobody really knows.

However, in other instances, the taking of minority stakes has been followed by a full-blown takeover. It can be a useful tactic for buyers, because minority holdings give their owners important rights and, potentially, crucial influence over and insights into a company. The downside for sellers is that potential buyers can use this strategy to put together a lot of information about your company.

When a bidder knows your company really well, they also know its weaknesses, something that could be very helpful at the due diligence phase and ultimately help them in the negotiation phase. A buyer in the know will have a strategic advantage over other bidders, able to better and quicker determine the correct value but also being aware of the various issued to be ironed out in the due diligence process.

As we will discuss later, momentum is a key determining factor in getting a deal across the line, and an informed buyer will simply have a better understanding of the buttons that need to be pressed to get there. Being able to track the asset for a considerable amount of time as a minority investor can prove invaluable when a larger transaction process kicks off and it can also deter other potential bidders as they will be unwilling to invest time in a process that they know they are unlikely to win.

The Glazer family's private takeover of Manchester United football club in 2005 is a great example of such tactical investment. The family ultimately, and controversially, loaded a previously debt-free business with more than £500 million of debt, some of it in the form of very high interest loan notes issued by hedge funds. In the context of boom-time leveraged buyouts, the financing structure used by the Glazers to acquire the company with its own money was aggressive, but not unusually so. But because the takeover was of a football club, which was completed in the teeth of opposition from the fans, it has generated more column inches about debt than many other deals in the decade since it completed.

In the midst of this furore, one of the more technically interesting aspects of the deal, specifically Malcolm Glazer's acquisition of an ever-increasing minority stake in the club, is often overlooked.

He began to build his stake in Manchester United in March 2003. A year later, despite the steady increase in his holding, Glazer announced that he had "no current intention of making a bid and may reduce his stake." That statement was forced by the UK's Takeover Panel in response to articles in the Financial Times and elsewhere that he had hired Commerzbank to advise on the possible structure of a takeover.

It is unclear in the context of this statement why Glazer would gradually continue to increase his stake until, in October 2004, his holding approached but didn't reach the 30 per cent level at which UK law mandates a full takeover offer.

The Glazer family discussed a bid for the club with Manchester United's CEO in October 2004. They subsequently relied on the rights and leverage their stake gave them to exert influence over the company, including the removal of three board directors in November of that year (replacing them with their own family members), as they fought a year-long battle to secure full control of the business. Think also about the information advantage gained by having the three board seats in terms of determining whether to proceed with a highly-leveraged offer.

That Glazer initially said he had no plans for a takeover did not stop widespread speculation that this was his intention all along and that the acquisition of an increasing minority stake was always a tactic to help win the club. In certain circumstances, this would mean that Glazer would have been skating very close to breaching UK laws on takeovers, which probably explains his extensive use of expert advisors.

In an open relationship

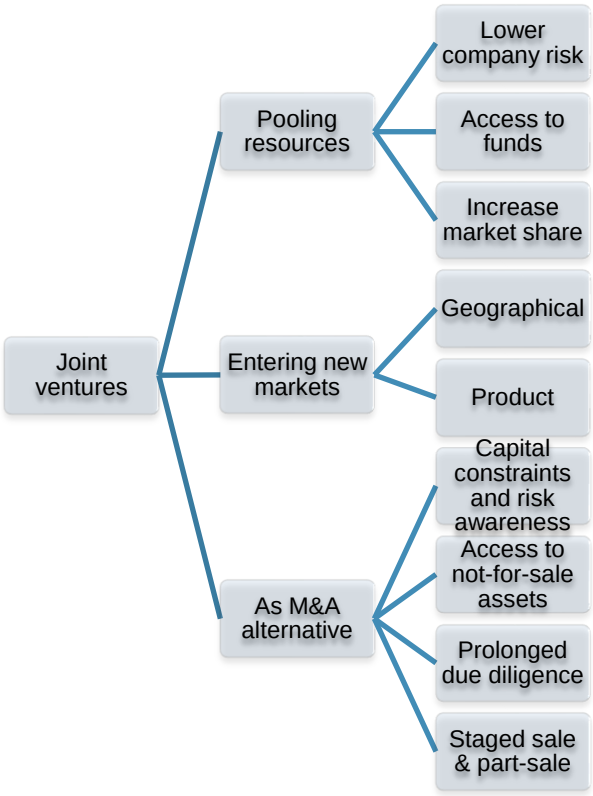
In the world of personal relationships, an open relationship seems to offer a dazzling chance to have your cake and eat it too. In reality though, such arrangements can turn pretty sour, pretty quickly. The corporate version of open relationships - strategic alliances or, more formally, joint ventures - can also be challenging. But, done right, they give companies access to industries or markets otherwise out of reach because they lack the necessary local or industry expertise, or the appropriate funding and scale.

The essence of all alliances is the same: two or more corporations agree to operate jointly for a common purpose that they each feel they are unable to achieve alone. There are many casual types of alliance, which are hard to research accurately, but we concentrate on the most formal, measurable type, a joint venture, where two or more partners invest together in a new vehicle.

There are three main reasons for investing in a joint venture:

1. JVs allow partners to pool resources. This is particularly useful from a financial perspective when credit is scarce, as in the period immediately following the economic crisis of 2007/8. But it need not be driven by finance: for example, another common driver to JVs is when companies need access to technologies and skills that cannot be bought. Because of these advantages, companies that are even competitors can team up (as we saw earlier with Microsoft and Apple), although obviously careful consideration is needed as it is difficult to set boundaries regarding what information you share with your partner.
2. JVs give partners access to new markets, either geographically or to new products.
3. JVs are sometimes used as a precursor to M&A, allowing cultural and other due diligence over an extended period.

Figure 0.2-B: Joint venture rationale



Unfortunately, as with human open relationships, the corporate version sounds great, but can be fraught with difficulties and many companies regret entering into them.

JVs – How to make them work

Comprehensive research by Cass Business School and Allen & Overy LLP, the law firm, of 500 global joint ventures – both large and small - between 1995 and 2014 demonstrates the potential pitfalls of such arrangements. The study found:

- JVs are not forever: In 60 per cent of cases one or more of the original partners had exited the JV or the JV had been dissolved
- Half of the exited JVs were successful: Some 50 per cent ended for a "positive" reason, but still 46 percent finished for a "negative" one such as a dispute (9 percent) or poor performance (14 percent)
- JVs are generally a medium term strategy: A majority (51 percent) of the exited JVs came to an end within five years of their start date. One year later, 61 per cent were over. Eleven per cent had reached their natural or planned end at the time, but in 53 per cent of cases one partner ultimately took control, and in 17 per cent the entire JV was sold to an external party

Following the study, Allen & Overy made the following recommendations for setting up a JV for success.

- Test your business proposition thoroughly
- Ensure the strategies of the partners are aligned from the outset; the success of the venture will depend largely on the "fit" of the partners.
- Devise workable decision-making processes

Up front, develop a workable exit strategy and dispute resolution procedures

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One company that fell foul of the open relationship quagmire is French food group Danone, which has made a number of unfortunate joint venture investments in China, a country where it is notoriously difficult to exit such arrangements.

Danone announced in September 2009 that it was exiting its partnership with China's Wahaha. Two years previously the French company had filed lawsuits accusing Wahaha and its founder Zong Qinghou of running a parallel copycat production line. Further, Danone had alleged Mr Zong, one of China's richest entrepreneurs, had defrauded it with the help of relatives and a fabricated facade of offshore companies.

To put that in context, Danone and Wahaha had been co-operating since 1996 and their joint venture was once used as a case study for success by business schools.

But serious cracks emerged when Danone tried to buy Wahaha out in 2006 and, according to The New York Times, the Chinese company appeared to be holding out for more money.

The two sides suspended legal hostilities in late 2007. In 2009, following extensive negotiations, Wahaha bought out Danone's 51 per cent stake in the joint venture. According to analyst estimates, Danone received around $500 million for a business valued at $2 billion.

Another example of the difficulty of exiting an international joint venture comes from the oil and gas industry. In 2003, BP put its Russian assets into TNK-BP, a joint venture with the energy oligarchs behind Alfa Group, Access Industries and Renova (AAR). By 2008 AAR was flexing its muscles in a bid to gain greater control of the company; TNK-BP chief executive Robert Dudley fled Russia, following what he claimed were politically motivated criminal charges linked to a government-backed campaign of harassment in support of AAR.

In January 2009, BP ceded control over the joint venture to AAR, whose board had previously been shared 50-50. Two years later the AAR board flexed its muscles again to prevent BP and Russia's former state energy company, Rosneft, from signing a plan to jointly explore for oil and gas in the Russian Artic.

Only in 2012 was BP able to extract itself from the impasse. AAR agreed to a plan to sell TNK-BP to Rosneft for $55 billion. The deal, which was personally cleared by Russian President Vladimir Putin, gave BP $16.7 billion cash and an additional 12.5 per cent stake in Rosneft.

Divorced

Divestment of under-performing assets, de-mergers and the liquidation of unprofitable divisions are largely outside the scope of this section, except insofar as they raise funds that enable refocused companies to go on the acquisition trail, or provide targets for buyers; however, we will return to these issues later when our book will come full circle to discuss corporate divorce.

A good example of a demerger is UK-listed Cadbury's decision to separate out its US drinks business Schweppes in 2008. The sale was designed to raise cash for an acquisition spree, but instead turned Cadbury from predator to prey and ultimately led to its acquisition by Kraft. Sir Dominic Cadbury - although no longer formally part of the company when it was bought - in a talk at Cass Business School following that takeover said that the demerger of Schweppes led to the ability of a larger food company to do a 'pure-play acquisition' to buy the confectioner founded by his great grandfather.

In May 2003, Todd Stitzer took over as CEO at Cadbury-Schweppes, then a drifting food and drinks company comprised of two ill-fitting halves: a global confectionary business and a US and European drinks business whose main brands were Dr Pepper, Snapple and Oasis. Although the acquisition of Adams in 2002 had made Cadbury Schweppes the world's biggest confectionary group, its global market share of the wider sector was only ten per cent, hardly a commanding position.

The company had long dreamed of dominating the confectionary business through a merger with Hershey and in 2002 had tried, but failed after the American business' controlling charitable trust stepped up at the last minute in to stop the deal. Cadbury Schweppes lacked the war chest for a proper spending spree so sold its European drinks brands, Orangina and Oasis, to Lion Capital in a first step to raise cash.

Nelson Peltz, the US activist investor, began taking an interest in the sector, buying stakes in Cadbury and unbeknown to the UK-listed company, also in its rival Kraft. Peltz's plans for Cadbury, to use it in industry consolidation, seemed to chime with those of Stitzer and the Cadbury board, so the UK company began slowly to discuss how to sell off its US drinks businesses, while privately re-opening talks with Hershey in the hopes of getting the trust onside with a proposed merger of equals. But Cadbury's US shareholders were pushing for an immediate split. Having failed to find a private equity buyer for the drinks business, the board was pushed into a US listing far sooner than it would have liked. In 2008, the Dr Pepper Snapple Group was listed in the US, bringing in cash that left Cadbury especially vulnerable to a takeover bid. Today the "unwanted" drinks arm remains an independent business, while the "jewel in the crown", the Cadbury confectionary arm was bought by Peltz's other target, Kraft, in 2009.

In a relationship

Once all other relationship options have been carefully considered, it is time for ambitious companies who still see a merger or takeover as the best option, to get engaged – that is, make an offer - and progress to marriage. That will be the subject of most of the rest of this book: to describe what can go wrong in a corporate marriage but also what can be done to avoid the main pitfalls and ultimately make it work. This can include the time when the companies are just talking to each other, seriously considering joining together ('in a relationship'), formally agreeing to merge ('engaged") or finally 'married'.

First Mover Advantage

A study into European CEO succession and M&A strategy by the M&A Research Centre at Cass Business School suggests that an early, focused, acquisition is the optimal action for many companies

Analysing CEOs in four European countries (the UK, France, Germany and Spain), the study found that those CEOs who were hired with a clear mandate for change were unsurprisingly the most likely to act quickly, within a year, to do their first M&A deal.

Those who embarked on deal-making in that first year bought assets more frequently than they sold them. An analysis of company share price found that CEOs hired by poorly performing companies (defined by weaker share price performance against their peers) tended to be those who sold, rather than bought assets.

While CEOs who sold assets benefited from a short-term bump as cash flooded into the company, often this was simply a "quick fix" which did not assist growth over the medium or longer term. In the longer run, the most successful strategy is buying in that first year.

But while the optimal strategy is to buy early, CEOs should be careful not to over-extend themselves. The study also found that CEOs who bought more than one company in their maiden 12 months saw a decrease in corporate returns over the long run.

As we will show throughout this book, CEOs with a clear strategy who act quickly and decisively to merge, and implement their decision using best practice, are well-placed to add value for their companies. After all, ambitious businesses, just as much as teenagers, often want and need to be "in a relationship."

Think Before You Buy: THE Dos AND Don'ts

- **Do first consider the alternatives to M&A – several options are available and they can be less risky than a takeover**
- **Don't enter into a joint venture or alliance before being comfortable – in principle and legally – that your and your partner's intentions are aligned**
- **Do consider divestments as a strategic option, as it can be more efficient to divest a division that is non-core than to buy additional capabilities to make it grow**
- **Do be prepared for M&A – it is very rare to stay single throughout your corporate life**

0.3. Avoid Tunnel Vision

So, you've run through the options and you believe that M&A is an answer to your company's strategic needs. At this point, you have to get the two fundamental foundations of successful M&A right. This means first formulating the best possible deal strategy and then putting in place an optimal target selection procedure.

The former is a precursor to long-term success, while the latter determines how companies implement that strategy day in, day out, long before they move on to the detail of due diligence we discuss later. Of our Three Big Mistakes of Deal-making, this chapr is all about planning.

At this stage you are trying to lay the foundations for your company's success in M&A and good planning is the key to this. "Unless you have a coherent business strategy, it's very hard to have a coherent M&A strategy. If that strategic intent is bought into by the board and employees, the M&A stuff follows easily," advises Paul Walsh, former Chief Executive, Diageo.

Generally, because the worst examples illustrate our points the most dramatically, many case studies in this book are object lessons in how not to approach M&A. But this does not present a fair picture of the real world. Outside of these pages, M&A is a key driver of corporate and economic growth; it is something that companies frequently do get right. Yet finding a poster child for successful M&A still remains much harder than finding a cautionary tale. And any "success" can only be measured in a medium-term window after the transaction has been bedded in, but before unforeseeable factors - unrelated and unable to be anticipated at the time of the deal, such as fundamentally new developments in technology or global geopolitics - create a different yardstick.

Looking at the period since 2008, Diageo, the global drinks producer, is one company who did get it right. At the conceptual stage it formulated the right strategy for the company and then it implemented that strategy well, getting the fine detail right. The company hit every "Do" in this chapter's M&A checklist. It was determined, yet flexible, in implementing its M&A policy, chasing down targets for years after first identifying them and then preparing in detail for tough negotiations.

Deal Strategy

M&A is in Diageo's DNA. At the heart of the company are its two forebears: Guinness PLC and Grand Metropolitan PLC, two London-listed food and drinks conglomerates who merged in 1997. Diageo's grandparents Arthur Bell & Sons, the Bell's whisky-maker, and International Distillers & Vintners are still recognisable in parts of the business.

Consider Diageo today and Johnnie Walker, Smirnoff, Ypioca (if you are Brazilian) or (if you are Turkish) Yeni Raki all come to mind: all top beverage alcohol brands with global or strong regional reach that Diageo has brought under its roof as part of a coherent M&A strategy.

The conglomerate's former chief executive Paul Walsh, who led the company from 2000 to 2013, had a key role in designing that strategy supported by a very capable senior management team. One of his first actions was to conduct a strategic review that put his clearly defined acquisition policy at the heart of the company.

From 2000, the company had clearly defined ambitions and was quickly mapping out the M&A pathways by which to reach them. During Walsh's tenure, Diageo's share price nearly quadrupled with much of that rise recorded in later years as corporate strategy was executed through deal-making.

As we highlighted earlier, new CEOs often do major deals in their first year because they are brought in with a mandate for change. For Walsh, thinking about M&A came even earlier. Asked to consider the top job a year ahead, he replied that he would happily take it, but believed the company as currently configured was not a global winner.

At this juncture before embarking on a program of acquisitions, a board should consider the full range of strategic options from disposals to a joint venture.

In an interview for this book, Walsh said, “Diageo had not long been created when I took over,” said Walsh. “We had four un-amalgamated divisions: fast food (the Burger King outlets), Pillsbury convenience food, spirits and Guinness. In my opinion every one of them was sub-scale. I thought we had done a good job on food improving the scale and margins, but there was no way I could see us getting into the Premier League of food players.”

The central tenet of the strategic review was fundamentally to reposition Diageo through a concerted acquisition spree. The company saw that for a modern, amalgamated “house of brands”, production and distribution was no longer its central purpose; marketing, tapping into the lifestyle aspirations of consumers, and cross-distribution were key. For that, Diageo needed to focus solely on alcohol, target recognisable luxury brands and, later on, to attract the growing middle classes of the southern hemisphere.

Diaego’s emerging markets acquisition strategy would reach its pinnacle between 2008 and 2013, as the company shifted investment geographically south. But it was Walsh’s early work that laid the foundations for the later focused acquisitions. In 2000, Diageo manifestly needed to divest to raise cash and concentrate on its core drinks assets. By the end of the year, Diageo had sold its food division Pillsbury – which included breakfast cereals such as Cheerios - to rival General Mills for $10.5 billion.

Two years later Diageo sold Burger King to the US private equity giant TPG for $1.5 billion. The latter deal, which took two and half years to complete - during which time both Burger King’s performance and the prospects for the fast food industry had deteriorated - was criticised by some as a bargain basement price. But, freed from its unwanted food interests, Diageo was now in a position to make the acquisitions necessary in its new core. Walsh noted this when he said, “There are times in life it is better to be quick than good. We were very fortunate.”

When the Seagram’s spirits and wine portfolio was put up for auction by Vivendi Universal in 2001, it represented a rare opportunity to participate in industry consolidation that few of Diageo’s rivals were ready for. Diageo, however, was.

Partnering with Pernod gave Diageo the cash to get a deal for the whole of Seagrams done quickly. The two companies tabled a winning $8.15 billion bid and shared the spoils, with Diageo taking the Captain Morgan rum brand it coveted. These early deals on which Walsh staked his career gave him a strong power-base that allowed Diageo later to build its emerging markets business – a geography they felt was underrepresented in their corporate portfolio of brands. He noted that “Buying Seagram and selling Pillsbury were the ‘bet the ranch’ deals. My position wasn’t at stake in the same way during subsequent deals, even though there were some very large ones.”

The first step to formulating an optimum strategy is selecting the right chief executive. For Diageo, Walsh was the right person at the right time, as shown above. A Diageo lifer, he began his career at Grand Metropolitan and knew the business and its people intimately. This experience helped him to make good decisions on merger strategy and gave him the strength to persuade the board to opt for his divestiture programme when just a few years earlier the company - and Walsh himself - had been building up its food divisions.

To see what happens when an executive attempts a transformational deal at a time of huge uncertainty, we need look no further than Royal Bank of Scotland (RBS) chief executive Fred Goodwin who pushed through the co-acquisition of ABN AMRO that his bank jointly purchased together with financial services company Fortis (of Belgium and the Netherlands) and Banco Santander (of Spain).

“The world’s biggest ever cross-border acquisition”, “the banking sector’s largest ever deal”, “the deal that nearly ‘bankrupted’ Britain”: RBS’s acquisition of ABN AMRO was a deal for which no superlative seems enough. “[The ABN AMRO acquisition] is a serious indictment of both the senior management and leadership,” according to the UK government in the Treasury Select Committee analysis of the Financial Services Authority [FSA] Report on the failure of the Royal Bank of Scotland.

The takeover Goodwin drove through was a massive failure in one of the industries most likely to damage the wider public good, just at a time when the financial system was creaking. Two of the three co-acquirors - RBS and Fortis - had to be bailed out by their governments in the wake of the hostile deal, so on that metric alone it may be the worst takeover in history.

The UK regulator that has since been disbanded in part because of its own failure to properly regulate RBS had this to say on the takeover:

> “The acquisition of ABN AMRO by a consortium led by RBS greatly increased RBS’s vulnerability. The decision to fund the acquisition primarily with debt, the majority of which was short-term, rather than equity eroded RBS’s capital adequacy… In the circumstances of the crisis, its role as the leader of the consortium affected market confidence in RBS.”

Goodwin, former RBS chairman Sir Tom McKillop and the bank’s former chairman Sir George Mathewson have been held jointly responsible for the failure, but it was Goodwin - who was stripped of his knighthood because of the fall out from the failed acquisition - who was Public Enemy Number One in the wake of the deal.

Could it have been foreseen or is it just a case of 20/20 hindsight?

A few industry mavens had been warning about Goodwin’s style for years. One example from several years earlier in 2005 was James Eden, an outspoken but highly rated banking analyst with Dresdner Kleinwort Wasserstein, who took his turn questioning the bank’s chairman Sir George Mathewson at an analyst meeting in the wake of the acquisition of Charter One in the US.

“Some of our investors think Sir Fred is a megalomaniac who cares more about size than shareholder value,” The Telegraph reported Eden telling Sir George as investors rebelled over another RBS acquisition, the arguably over-priced Charter One deal.

Ironically Goodwin’s fall from grace was almost certainly built on his initial success. In banking circles he was considered a Scottish upstart in the City. Goodwin started out as an accountant at Touche Ross before taking over as deputy chief executive of Clydesdale, a small Scottish bank owned by National Australia Bank (NAB).

When Sir George poached him to be the deputy chief executive of RBS in 1998, he was already known as “The Shred” thanks to his abrasive cost-cutting style. Goodwin’s role in RBS’s takeover of NatWest - still considered one of the best deals in the UK banking industry - set him up in an elevated position.

In September 1999, NatWest had been due to merge with the insurer Legal & General. But investors hated the deal and forced out the bank’s chief executive Sir Derek Wanless, leaving the bank rudderless. RBS pursued friendly talks with the Bank of Scotland, but Sir George and Goodwin were plotting a rival offer for NatWest.

The FSA backed this view. “RBS’s track record of successful acquisitions and integration, particularly of National Westminster Bank (NatWest), may have led the RBS executive management to be confident in its ability to integrate the ABN AMRO business. It is clear that RBS underestimated the operational and integration risks that arose from the acquisition,” said the regulator.

One of the prime architects of the ABN AMRO deal, RBS's former global head of investment banking Johnny Cameron, echoed these sentiments when he later spoke to FSA officials as part of the inquiry. "After we bought NatWest, we had lots of surprises, but almost all of them were pleasant. And I think that lulled us into a sense of complacency around that."

Goodwin went on to deliver not only the takeover, but also £3 billion of post-integration synergies. Once Sir George was elevated from chief executive to chairman - a move that goes against the standards of UK corporate governance norms - his protégé cemented his position further.

There is no question that the corporate governance practises at RBS were partly to blame for the failure in ABN Amro. Having a non-biased, accountable board with relevant experience and expertise that can challenge management is key ingredient in getting a deal right, especially as it will help executives getting too emotionally attached to the deal or a particular target and in so avoid tunnel vision.

For small and medium sized businesses there are useful lessons as well from this case. For smaller, often non-public companies, having board members with experience in deal making is equally important, however for slightly different reasons. Top executives in these businesses are often more operationally involved and therefore have less time to meet with and get to know potential target companies.

Having experienced board members (often the Chairman) to navigate the more difficult discussions with counterparties, both with target companies and potential investors, can be very helpful in order to keep ongoing relationships intact. In this light, growing companies often seek out board members with such experience, often as non-executives or independent board members or, in the case of family-owned businesses, an advisory board.

Target Selection

Target selection is where companies put into practice their well-thought out, coherent deal strategies. As we will see, it is work that goes on not just immediately ahead of a deal, but day in, day out, for years. It is in this sphere that Diageo truly excelled.

Diageo built on its early M&A success. The company's transformational deal with Seagram had helped it to position itself, particularly in the US, but by 2009 it had become clear that Diageo was too dependent for revenue on developed markets, particularly in Europe. Around two-thirds of its revenues were from North America and Western Europe at a time when growth was stagnating in both regions in the wake of the credit crisis.

At the same time, emerging markets were booming. As Goldman Sachs Chief Economist Jim O'Neill coined the acronym BRIC [Brazil, Russia, India and China], so Diageo began to focus beyond its established markets for growth, kicking off a strategic project to help it identify the best regions for fresh investment.

The company decided to target the emerging middle class in Latin America, Asia, Africa and Russia/Eastern Europe. Such consumers were identified as households with an annual income of between $5,000 and $35,000, entering an income bracket at which they could afford to think beyond meeting their basic needs and becoming aspirational in their way of living.

Explaining his thinking at the time, Walsh said, "We had been looking at emerging markets before then, but in 2008-2009, it was clear the world was going to change. It was my belief and the board supported it that Europe was going to be lacklustre for a period of time."

He added, "The way to offset that was to harness the economic power in these new markets. As I stand here today when we have seen some of the bloom come off that rose, I still believe that one

of the few things you should not bet against in economic theory are demographic trends. When you combine those with even modest per capita gap growth and you get a very exciting story".

In 2009, Diageo set out to reach a 50-50 split in terms of revenue generated from developed and emerging markets and since then has focused most of its acquisitions there. The right target companies would provide access to the targeted consumers and would help to build Diageo's distribution network in areas of the world where it was not possible to build that position as quickly organically, boosting overall corporate integration.

Perhaps best of all, there were several potential targets in most key markets, all medium-sized bolt on acquisitions, so it made target selection process much easier. If Diageo selected the right acquisitions and remembered not to get fixated on just one, it need not overpay.

Having spent the previous nine years heavily involved in M&A, in 2009 Walsh was now well-placed for the next round of acquisitions having the confidence of the board, investors, staff and advisors. The company had also designed its own comprehensive system to run a deal project.

Figure 0.3-A: Diageo's deal process

	Steps	Description
1	Ideas generation/sourcing:	Executive Committee strategy, local market strategies, global category strategies, M&A team reviews and advisors. All with the aim of demonstrating a compelling opportunity.
2	Issuing project alerts:	○ Documenting strategic rationale, preliminary financial returns, investment dashboard, early assessment of deal issues and RASCI (parties responsible, accountable, supporting, consulting and informed) ○ Request authority from CEO/CFO to start negotiation process
3	Deal making:	○ Project valuation ○ Project negotiation ○ Perform due diligence on target ○ Project integration planning
4	Project Approvals:	○ Final approval request to CEO/CFO and Board of Directors
5	Post-deal completion reviews:	The first review is done one year after the deal is completed while a second review is done three to four years post completion.

Source: Diageo Business Development

Diageo says "Saúde" to Ypióca

On May 12 2012, Diageo issued a press release announcing a deal with Brazil's Ypióca Agroindustrial Limitada to acquire its leading drinks brand for £300 million. A textbook Diageo acquisition from its emerging markets period, it is a prime example of the company's tenacity in M&A and is equally useful as a case study to show how a medium-sized company can 'sell' itself or divisions to a larger company.

In the decade leading up to 2008, the economy of Brazil had been transformed and was now amongst the ten biggest in the world. With a very young population - 50 per cent of Brazilians were under the age of 29 at the time - the country's demographics promised an economic boom that would create exactly the growing aspirational middle class with disposable income that Diageo sought.

It was estimated that 57 per cent of the population - or 113 million Brazilians - would be middle class by 2014, the year Brazil was due to host the World Cup, with more joining their ranks by 2016, when

Brazil would host the Olympic Games. Those two sporting events were in themselves expected to combine to increase the country's consumption of beverage alcohol significantly.

Diageo focused on cachaça, the Latin American spirit used in caipirinha cocktails, as the best prospective investment. Cachaça, Brazil's "national drink", is a spirit distilled from fermented sugar cane juice that has dominated the local market for about 500 years.

Consumption was almost exclusively domestic, but sales of the premium segment were growing and Diageo believed it could adapt its vast knowledge of other global brands, as well as other national drinks such as Mey Icki Raki in Turkey and Zacapa rum in Guatemala.

Brazil has over 4,000 different brands of cachaça and Diageo's preferred choice was the high qualityYpióca. The target was an attractive brand with the obvious additional appeal of a distribution network in the north-eastern region of Brazil that Diageo could leverage to drive sales not only for Johnnie Walker whisky and Smirnoff vodka, but for its other emerging middle class-targeted brands.

When Diageo first approached the owners to explore a deal, the analysis, valuation and due diligence were longer and more complex than initially expected because the assets had to be 'carved-out' from Ypióca Agroindustrial Limitada. Diageo therefore continued to keep its options open throughout in case the deal did not proceed.

ABN: "It's hard to see what's in it"

Then there's the wrong way to do it. In its bid for ABN Amro, RBS got fixated on a single target, made a takeover decision seemingly based on emotion and hubris, and turned up to a sale late. Not a good combination.

In January 2007, as RBS's investment banking advisor Merrill Lynch briefed it on a plan to lead a break-up bid for ABN Amro, Goodwin's power was unchallenged, as we discussed above.

Analysts had long suspected ABN Amro was the sector's next takeover target, a likelihood that was confirmed as London-based hedge funds, including Toscafund, by then run by the now-retired former RBS chairman Sir George Mathewson, began to take stakes in the bank.

Unfortunately for Goodwin and unbeknownst to him, ABN Amro had already met just days earlier with his UK rival, John Varley, chief executive of Barclays Bank, to discuss a consensual takeover. Being late to a takeover party is often fatal and, in this instance, ABN Amro's chief executive Rijkman Groenink told him that ABN Amro was not for sale, even as he discussed terms with Varley.

On March 18, Barclays gave Varley approval to pursue a takeover and the story broke in the UK press shortly thereafter.

RBS, knowing an outright bid for ABN Amro would be blocked on anti-trust grounds, began to assemble a raiding party that ultimately was made up of Fortis and Santander. The latter was a long-term investor in RBS, with a seat on its board seat.

Despite the fact they had had no access to confidential ABN Amro information - particularly important in financial sector deals but critical for proper due diligence and pricing in any deal - and that Barclays did have such access as they were well into their due diligence process, the consortium launched a hostile bid on April 15 at a higher price than their rivals.

The decision to proceed without due diligence is ultimately what cost RBS its solvency because ABN Amro's investment banking division contained some of the most toxic subprime debt around. While we consider due diligence later, here it is indicative of a more fundamental problem - CEO hubris. RBS's decision surprised the market. This issue regarding due diligence – or rather the lack of it - was singled out by the FSA retrospectively as one of the biggest problems with the deal.

> "In proceeding on that basis, however, RBS's Board does not appear to have been sufficiently sensitive to the wholly exceptional and unique importance of customer and counter-party confidence in a bank. As a result, in the [FSA] Review Team's view, the Board's decision-making was defective at the time."

One important element to the deal for RBS was ABN Amro's US arm, LaSalle Bank, a better business than RBS' own Citizens Financial Group (itself an RBS acquisition from 1988). Realising this, ABN adopted a lock-up sale defence, whereby it sold what the unwanted bidder most wanted, striking an agreement to sell LaSalle to Bank of America and thereby making it impossible for RBS, if it successfully bought ABN Amro, to merge LaSalle with Citizens.

Yet RBS continued to pursue ABN Amro, re-justifying its strategy on the strength of synergies between ABN's investment banking operations and RBS's own similar Global Banking and Markets (GBM) business.

As spring moved into summer, RBS' may - or may not - have tried to get out of the takeover, but the bid stood.

Commentators in the UK press thought RBS and Goodwin were out of control, and said so. "For RBS, the task is to convince its own shareholders the bid is still worth the candle now that LaSalle is lost … Someone will lose," said James Harding, then Business Editor of The Times, in July 2007. "And if it's hard to see why [Barclay's boss] Varley is staking his reputation on ABN, it's now even harder to see what's in it for Sir Fred – other than winning."

Barclays, perhaps because of what it had seen was inside ABN Amro, never hiked its opening offer. In September 2007 RBS's bid for ABN Amro closed and the bank was finally able to see what they had bought. As the financial crisis continued, RBS found that they had bought a bank full of dangerous liabilities.

Before the deal had closed, the governments of The Netherlands and Belgium had to partly nationalise RBS's partner Fortis. RBS, which was thinly capitalised and had financed the acquisition through the failing wholesale credit markets, was well on its way to the same fate.

In the rest of this book, we will tell you how to recover from deals that are going wrong. Here there was almost certainly only one way to recover - to walk away.

By not counter-bidding, Barclays did walk away and it helped the bank to avoid compulsory nationalisation when its biggest rival had to be bailed out. Sometimes the best deals are those not done.

Patience is the Watchword as Diageo says Şerefe to Mey Īçki

If you really want an asset, your corporate ambition needn't put you at a disadvantage. One of Diageo's first emerging markets acquisitions, Mey Īçki in Turkey, demonstrates that if you really want something, you must play a dispassionate long game.

As part of the process to move Diageo further into emerging markets, Diageo had identified Turkey as one of the target countries. Turkey was, in many ways, was even more attractive than Brazil as it already had a fast growing middle class with consumer spending forecast to grow at six per cent per annum - twice the rate of GDP - by 2010. Turkey was also seen to be a good place to do business - it was ranked 61st in the global business practice index, higher than all of the BRIC countries and even EU countries such as Greece and Italy.

So when the Turkish government privatised Mey Īçki in 2004 as part of its sale of TEKEL, the company came onto Diageo's radar as a possible investment. Ultimately Mey Īçki, which was in need of a more modern management, was sold to US private equity group TPG. But Diageo had not forgotten about it.

When it came time to exit the business in 2010, TPG - who had bought Burger King from Walsh eight years ago - remembered Diageo's interest in Mey Ïçki.

By this point TPG had thoroughly transformed the company, creating what they considered to be a world class distribution system that was ready to use for Diageo's international brands. However, with the Turkish company already in the preliminary stages of an initial public offer [IPO] process, it wanted a full price for the asset.

At the same time, the deal was one of the largest Diageo had executed in an emerging country for many years, and it needed for its strategy an asset it could be completely certain about; this meant price was more flexible than usual.

Keeping an open mind, Diageo considered the potential scale of the local raki spirit market including the local political and economic conditions, especially critical for an alcohol beverage company buying a manufacturer and distributor of alcohol in a country where the majority of the population was Muslim.

Diageo was able to negotiate price with TPG but knowing the strategic worth of Mey Ïçki to its emerging market focus, it had to take a balanced approach making sure that the price was not too far below TPG's expected IPO valuation.

Eventually, a deal was struck between principals and announced in February 2011. The final price represented 9.9 times the 2010 EBITDA of TL333 million (approximately $208 million or £133 million), a full price, but at a level where Diageo was still a keen buyer.

Has the "bloom gone" at Diageo?

As previously stated, for the purposes of M&A strategy, we assess Diageo's success only within a particular timeframe, in this case 2000-2013.

But, although Diageo had nearly reached its target of earning 50 per cent of its global revenues from emerging markets by the end of 2014, profit growth from outside of Europe and US had begun to fluctuate.

Some of the challenges have been created by factors outside of Diageo's control including weakening currencies in South Africa, Turkey and Venezuela, as well as the anti-extravagance crackdown in China that reduced demand in that country for its premium spirits.

But that does not negate the company's success. Walsh, who has followed his time at Diageo with a position as the non-executive chairman at Compass, commented in 2015 that "Diageo is in a phase whereby there is not just economic uncertainly, but political and security uncertainty. So we are inevitably going to see volatility, but you still can't bet against those long-term demographics.".

What is clear is that overall emerging markets acquisitions helped to transform Diageo from a North Atlantic company to a truly global leader. Perhaps most importantly, the company decided what was the best thing to do based on the information it had at the time and implemented that decision with unusual rigour.

In this regard, it's useful to recognise the differences between emerging markets and the more developed markets. Allan Taylor, M&A partner at the global law firm White & Case pointed out the following: "In emerging markets, generally speaking the deals are more likely to fail due to the seller and buyer taking a very different view of the market growth potential of the target. When combined with different risk appetites for due diligence issues, execution certainty and market risks, this can create a real potential for serious disagreement regarding pricing and willingness to commit fully."

However, he went on to say, “In developed markets we see tend to see deals failing due to a loss of momentum caused by lack of internal support and lack of certainty about being able to achieve strategic premiums. That comes down to planning and leadership of the key people. In public markets with share for share deals, there is also the issue of properly communicating synergies to the market and the ability for target shareholders to see upside in the combined entity; bidders must ensure that they effectively sell the benefits of the acquisition to the target board and shareholders and other key stakeholders." This communication is absolutely critical and one of the Big Three mistakes that need to be avoided.

Small, family-owned businesses can do this well, even when staying local. Timpson traces its origins back to 1865 when William Timpson opened a shoe shop in Manchester. It remains in the family yet now has expanded throughout the UK through acquisition, into key cutting, watch repairs, engraving, dry cleaning and photo processing. Although these may not seem to be linked, the selection of acquisition targets follows a formula. The preferred targets? Businesses in distress.

As John Timpson, great great grandson of the founder explained, ‘We try not to buy anything that’s doing very well. You’ve got to pay a lot of money and then you’ve got to do it better than someone who was doing quite well before. It’s much easier to do a great deal when buying a crap business; we want to be the last man standing in an industry that no one else likes.’

As an example, in late 2008, Timpson bought 187 of the Max Spielmann’s photo-processing stores out of administration for £1.3 million, substantially expanding its own coverage in England and Scotland, together with the transfer of 545 employees to Timpson. But 127 stores were not purchased, as the company had a rigourous process in deciding what was of interest. Notably, within eight months, the purchase price had been recovered from the profits generated by those 187 stores.

Frequent buyers who get their deal strategy right will know and appreciate the value of maintaining a ‘live’ list of possible targets. The number of potential targets you need to review to reach a completed deal will obviously differ from time to time but as a rough estimate, a 100 to 1 ratio is a good benchmark.

Figure 0.3-B: Target selection process – The 100-2-1 ratio

As we have seen with the RBS and ABN Amro case, getting fixated on a particular target or situation can be dangerous, so maintaining such a list of possible alternatives is crucial. A well-defined and mapped target universe will also help identify the priority companies where it is worth investing more time to ensure that you are – as a bidder – well placed when a deal situation does arise.

Avoid Tunnel Vision: Dos and Don’ts

Setting the M&A strategy:

- **DO have a clearly defined M&A strategy on which the Board and the CEO are aligned.**
- **DO be explicit about what each and every potential target will contribute to your overall corporate strategy and have options. DO have good corporate governance structures in place including strong and experienced non-executive directors: a CEO who simply hears confirmation of his own ideas will make bad decisions.**

Implementing your strategy:

- **DO stay flexible - more than one takeover target can often deliver the same strategic aim.**
- **DON'T get fixated on a single target - this means looking at up to 100 targets for every one you buy.**
- **DO be committed to delivering on your M&A strategy**
- **DON'T make a takeover decision based on emotion or hubris**
- **DO be prepared to chase a target for many years once you have identified it.**
- **DON'T be late to a takeover battle - if you are late to the process, you will very rarely win even if you do acquire the target**

0.4. Knowledge is Power

When the UK's financial regulator began the first of many reviews of RBS' catastrophic takeover of ABN Amro, it described the British bank's due diligence on ABN Amro as "minimal." That any buyer - let alone one of the world's biggest banks - could be satisfied to proceed with a takeover after only a "minimal" assessment of the hugely complex financial instruments held by another bank, is mind-boggling. It is safe to say that RBS' due diligence on ABN Amro was a complete failure - as quickly became clear when RBS took control and discovered ABN was riddled with toxic debt.

Legions of buyers have begun on a much stronger footing than RBS - many with a reasonably solid M&A vision - but ultimately their acquisitions have failed to bear financial fruit because of mistakes at the due diligence stage. This is true whether the target is large or small, as we should not assume that because the acquisition is much smaller that it is easier.

Of the case study failures we consider in this book, mistakes during the due diligence phase were often either the underlying cause of the failure of their takeovers, or at the least the nail in the coffin. Whilst due diligence might be seen as the dull sibling of other more newsworthy areas of M&A such as regulatory battles or hostile bid tactics, things often go wrong for the buyer in the data room.

For the purposes of our Three Big Mistakes of Deal-Making, here all eyes should be on planning and people. Getting the right level of due diligence done should be part of the company's broader M&A plan and - if it is done properly - the information gleaned at this stage will continue to be useful through the integration phase and beyond. Within this, it is important that due diligence also covers the target company's people and culture: after all, the 'assets' that walk out of the door and go home every night are often the company's most valuable ones. The cultural implications of a corporate marriage are the single most important determinant of deal success, yet the issue is most often overlooked in the due diligence process.

When a bid is hostile - as in the case of RBS' bid for ABN Amro - a lack of due diligence is a risk that is knowingly undertaken and should be fully understood as making the takeover more risky and prone to mistakes. But even when the target provides full access, there should be full due diligence conducted. Often, friendly 'full access' will lull a buyer into a process where they put off the due diligence until late in the process. This can be particularly true with deals between two smaller companies who know each other well from the market and who are entering a friendly deal to merge together. But even in larger deals when an approach is friendly - so proper time and access to due diligence is available - there is little excuse for these types of errors. Yet they still happen, as in the Volkswagen / Rolls-Royce deal we will discuss.

Sometimes particular circumstances dictate that a transaction must be hurried - as we discuss later with our case study on Britvic - but here the expectation is that the buyer has enough pre-existing research or industry expertise in its locker to be able to pull the deal off. And should do so with eyes wide open.

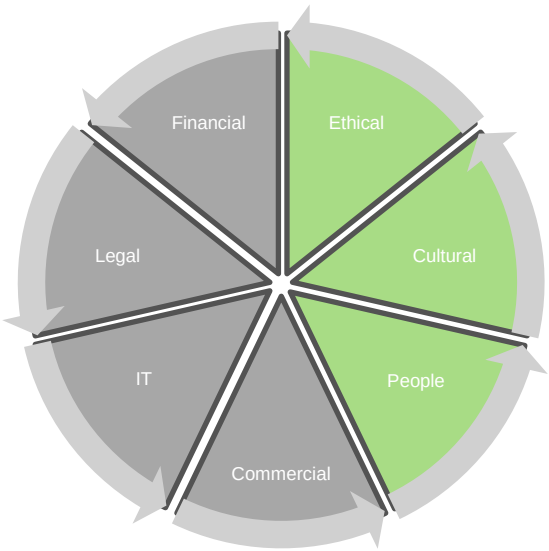
We will provide an overview of the pre-announcement due diligence process, and touch on what is different in cross-border M&A. In terms of our Three Big Mistakes of Deal-making, bad due diligence tends center around with two potential problems in particular - poor planning and poor people management.

Due diligence is absolutely intertwined with fixing the correct value on the target, a function that can only properly be finalised at the end of the due diligence process. A thorough approach will give a bidder the appropriate foundation in fixing the correct walkaway price. For this reason this section of the book and the following one on valuation should be read together.

Where is Diligence Most Due?

Performing thorough due diligence is absolutely critical to ensure deal success. It tends to focus on the buyer reviewing documentation and interviewing stakeholders about the target but a good due diligence process also involves the target firm assessing the style and intention of the bidder.

Figure 0.4-A: Areas of Due Diligence



Traditionally due diligence has been confined to tangible disciplines - primarily financial, legal, IT, operations and commercial. Conducting a takeover only through that narrow prism, however, can be very damaging; "softer" issues such as people and governance, culture and ethics are equally important. Poor due diligence and a lack of understanding of the correct valuation of "softer" assets such as management and key employee retention created huge losses for shareholders in cases such as HP's takeover of Autonomy that we discussed in the Introduction or the well-known case of and Microsoft's acquisition of Nokia Handsets.

New systems for measuring IP and intangibles have been created to deal with just such failures as the corporate world has moved on. Other risk factors, such as cyber security, have already found a place on the due diligence check list, following a number of high profile cases such as adultery website Ashley Madison's potential planned IPO in 2015 prior to a very public hacking. This area of cyber security has been critical as well in M&A deals ranging from the retail industry to financial services, in both public deals and private.

Another example of emerging due diligence is a company's social media policies and footprint, where a target's social media presence on Twitter, Facebook and other platforms should come under as much scrutiny as other areas of due diligence. This is especially critical as often these new media areas within a company are run by younger, less experienced staff in teams who may even work on-line remotely and thus not be located within the corporate headquarters, and therefore would not normally have been included in the due diligence process. This on-line presence for many companies is their virtual shopfront for many and, in some cases most, customers.

Yet it is important to remember that there are still many pitfalls even in "traditional" due diligence.

If you buy a Rolls-Royce car today, it will have been manufactured in Goodwood in West Sussex, England. But you will actually be buying it from BMW - the German giant took control of the Rolls-Royce business in 2003. Had M&A history gone to plan, you'd be buying the car from BMW's bitter German rival, Volkswagen. Instead the Rolls Royce v Volkswagen deal presents what many would call one of the worst intellectual property mistake in history.

In 1998, Vickers, the British manufacturing firm that had owned Rolls-Royce and its sister car brand Bentley since 1906, was struggling against the tide to keep its manufacturing going. Other British

car manufacturers had sold out to their continental European and US rivals decades earlier and there was much national gnashing of teeth as Vickers moved to sell off one of the final bits of Britain's proud automotive history.

Production of expensive Rolls and Bentleys had fallen to just 17,000 in 1997, and the majority of those were Bentleys. Other than a factory in Crewe with 2,500 employees and a reputation for fantastic automotive hand-finishing, the business up for sale had few real assets except its brands.

Rolls Royce's destination was always likely to be Germany. BMW, which already supplied engines and parts for the cars, looked like the obvious destination. But the car manufacturer's final offer of £340 million, was easily beaten by a bid from Volkswagen for £430 million.

But there was a legal wrinkle in the deal structure. The Rolls Royce business got control of the brand name and the famous "RR" trademark when Rolls aircraft engine and car businesses were split as part of a government nationalisation in 1971. Under that agreement, Rolls Royce was not allowed to sell the Rolls name as part of any deal that sold off the car manufacturing business.

Unfortunately VW's lawyers did not realise this. The German car manufacturer got all the IP rights to the cars themselves - the design rights of the luxury interior, the body and even the famous Spirit of Ecstasy hood ornaments. Effectively, they could build the cars, but not advertise or sell them as Rolls Royce.

History does not record the private reaction of VW's ambitious chairman Ferdinand Piech when he uncovered the mistake. But there might have been a few expletives exchanged. Matters got worse because BMW leveraged its close ties with Rolls-Royce to licence the brand name from under VW's nose for just £40 million.

However, the downward spiral doesn’t stop there. BMW's contract to supply vital engines and components to Rolls-Royce - which were effectively just hand finished in the UK - could be cancelled at 12 months’ notice. VW did not have time to re-engineer the Rolls-Royce engine itself without taking production offline so when BMW threatened to stop supply, it forced the clash between these close rivals to a head. The matter looked like it was heading for court, but the German government intervened to push the two sides to arbitration.

Under the deal BMW would continue to supply engines for the cars and would let VW use the brand name from 1998 until 1 January 2003. But from that date, only BMW would be able build cars bearing the Rolls Royce name, while VW would be left building cars known as Bentleys. Effectively BMW had bought Rolls-Royce for a tenth of the price paid by VW for Bentley, because they had done their legal homework.

Due Diligence in Cross-Border M&A

The long-term trajectory of M&A activity is remorselessly upwards, despite temporary blips in the economic cycle. So is the trend for cross border deals with international M&A activity growing even more quickly than domestic deals?

The background to this increased international activity is the growth of a global middle class, hungry for new products and services, as witnessed by Diageo’s strategy for buying into the growing drinks market in Brazil and Turkey that we showed in an earlier section.

And cross-border M&A growth is set to continue over the long term. It is estimated that the global middle class will more than double in size from 2 billion today to 4.9 billion in 2030, according to the OECD. Driven by growth in China, India, Indonesia and Thailand, Asia is expected to host almost two-thirds of the global middle class by 2030 and account for 40 per cent of global middle class consumption, according to Reuters.

In countries in South America and - to a lesser extent Africa - M&A interest is shifting from natural resources and raw commodities to services such as healthcare and financial services, as well as luxury and near-luxury products. New commercial networks are emerging to serve M&A and expansion in fast-growing parts of the world, in particular a new "Silk Road" whereby South-South trade between Asian and South American countries bypass Western commercial centres. Again, this can only bolster M&A growth.

Whilst cross-border M&A, as with many topics in this book, could be the subject of a whole book, it is worth considering a few of the basic principles for good practice here:

1) Know your market

If you really understand your market, then it can't be "Europe" or "South America." Bolivia and Argentina share a border, but they are as different ethnically, culturally, geographically and linguistically as any two countries on the South American continent. Deal processes and legal systems are also not the same. Transpose that rule to Europe and the same could be said of Italy and Sweden or France and the UK. Local knowledge needs to be really local, certainly to a national level and sometimes even down to region within a country.

2) Politicians are fickle – and they can derail a deal

Any nation has the potential to become interventionist under the right circumstances. After a long history of welcoming foreign investors, the US government blocked Dubai Ports World's rights to US seaports that came under the company's control when it bought UK-listed P&O. At the time, in 2006, the UAE was one of America's strongest Gulf allies but public concerns about security in the wake of 9/11 overrode all logical business and international relations arguments.

3) Be prepared for longer, deeper due diligence

Be prepared to spend twice as much time and maybe money to get the same result as on a domestic deal.

4) Choose the right cross-border partner

Diligent partner selection could be one of the most important factors in the success or failure of an international joint venture or strategic alliance. If you are going to do that to "get into a relationship", you'll certainly want to redouble your efforts if you are making the next step to propose a corporate marriage.

5) Truly understand the people culture

As with M&A generally, it is easy to overlook the human component of any deal. Cultural nuances are critical, both in completing the deal during the planning and negotiation process, but also later down the road when the deal needs to be implemented by the local team.

How Long Should Due Diligence Take?

The answer to that question, if you are the buyers seeking the right information about the target and its market, is that it should be as long as it takes to get the answers. Even if you are doing a friendly deal where you have full access to the target and the deal hasn’t yet been announced or been leaked to the public, you will need to find out where the right information resides and what it really means. You will, however, want to do this as quickly as possible because you are under significant time pressures to avoid competing bidders and the possibility that employees, clients and suppliers will leave the target.

As a general rule of thumb, very large or financially complex target companies and all publicly listed companies will require the most due diligence, although listed sellers will want to limit what they

make available because what is given to a friendly bidder must be shared with any rival bidders if they appear on the scene.

But crucially, research demonstrates that not only does longer due diligence result in a higher likelihood of success, but buyers as a group do better the longer it takes because it lowers the ultimate acquisition price.

When no one knows: pre-announcement M&A activity and its effect on M&A outcomes

There is a link a between longer due diligence period and the success of a deal as well as the payment of a lower premium, as found by research by Cass Business School's Mergers and Acquisitions Research Centre for Intralinks conducted in 2013.

The study was based on research on a sample of 519 publicly announced M&A transactions which used an Intralinks virtual data room (VDR) for due diligence between 2008 and 2012.

Although the link was a generally held truism, this was the first time its existence had been actually proven. The study found shareholder returns for acquirers to be significantly higher where due diligence was longer with acquirers outperformaning by 18.8 per cent when they had a due diligence period longer than the average compared to 6.7 per cent below the index for acquirers involved in deals with shorted due diligence period.

There are sound reasons why this should be the case. Longer due diligence allows buyers to dig deeper and find information about the target that it can use to negotiate harder on the price. However, the study provided anecdotal evidence from interviews with practitioners that indicates that there may be a ceiling on this advantage: even a friendly seller - particularly one that has other options - could become bored or insulted by too much due diligence and call time on a deal.

Sellers often try to limit the due diligence period for this very reason, although their ability to do so will depend on their power in the market and - particularly - the existence of rival bidders.

Irn Bru and Britivic Indian Tonic Water taste very different, don’t they?

Although a longer due diligence period tends to benefit the buyer as it gives them more time to unearth information which they can use to negotiate down the price for the target, there are times when an opportunistic buyer wants to prioritise a quick deal, either because a target is so distressed it needs to be rescued, or because there is a one-off opportunity where the target, particularly a rival, is temporarily on the back foot.

Because the need for speed reduces the opportunity for long due diligence, outright “rescue” takeovers of insolvent or distressed companies tend to be low cost and are the preserve of specialists. But the opportunity to buy a troubled rival or, from the perspective of a struggling business, the chance to attract a helpful industry partner, can be too attractive for even the most cautious of corporates to pass up. The problem is that in the heat of the pursuit, there is too great a temptation to bypass the due diligence basics we outline in an earlier section even for the traditional areas of legal and financial information that almost all firms insist be done before a deal closes. And in that rush to do complete a deal, it is even easier for mistakes to be made in the “People” category of our Three Big Mistakes of Deal-Making by making ill-thought out decisions about the proposed partners’ executive teams and their corporate culture.

Another balancing argument against a longer due diligence process is the important issue of maintaining the deal momentum. As we will see in the case of the proposed merger between Britvic and

AG Barr, two UK-based beverage companies, maintaining momentum and having all parties aligned is crucial if you want to reach a deal. As time moves on, even for just a few months, so do the industry dynamics and the need or want to sell or buy. In short, the deal may stall, but the rest of the world doesn't.

The answer is of course to have a very clear and detailed check-list and process in place before commencing due diligence. In deal situations you often hear about the 80/20 rule, that is, that there are the very important aspects of due diligence, the 80 per cent, which you need to fully understand and sign off on before a deal can be signed. The remaining 20 per cent - often the smaller issues which can take as long as the first 80 per cent to get to the bottom of - are issues which are not deal-breakers and ones which the buyer can take a punt on in the pursuit to close the deal quickly. Caution is clearly needed but with the right planning, and significant pre-diligence completed, this can be an effective deal strategy.

When trouble-hit UK drinks business Britvic announced it was in £1.4 billion merger talks with Scotland's AG Barr, analysts cheered plans to create what was described in the deal announcement as "one of the leading soft drinks companies in Europe."

For Britvic's shareholders - who had also suffered a recent profit warning in 2011 - its smaller listed rival looked like a cost-cutting knight in shining armour. Britvic's medium-term troubles had just been significantly compounded by a forced safety recall of its child-focused Fruit Shoot drinks, which knocked 35 per cent per cent off its share price; combining with a well-run AG Barr seemed like the answer to their financial woes and what the Financial Times in September 2012 described as its "highly leveraged" balance sheet.

Shareholders of AG Barr meanwhile had recently seen their company shake off its sleepy image with fast-growing youth-focused drinks such Rockstar and Irn Bru. What looked like a reverse takeover of a struggling larger rival, according to The Telegraph seemed an excellent and timely bit of business.

"The combination has compelling commercial and industrial logic," the parties said in their joint statement.

In addition, they promised that a merged Britvic-AG Barr would deliver synergy savings of £40 million a year by 2016 as well extending Britvic's strong relationships with Britain's biggest supermarket chains and with its international partner and major shareholder, Pepsi, to the rest of the business.

Few investors grumbled initially, but as the market digested the merger, a few began to question its logic. In November 2013, an activist investor and Britvic's eighth largest shareholder, publicly criticised the deal as "poorly negotiated." The "no-deal" camp got more bad news when it emerged AG Barr was to get half the seats on the combined board, in addition to the all-important chief executive role that was to go to its highly respected chief executive Roger White. Yet despite these challenges, only six per cent of Britvic's shareholders ultimately voted against the deal.

The tie-up was made contingent on approval by the UK's entry level competition authority, the Office of Fair Trading [OFT] (whose functions have since been reorganised into the Competition & Markets Authority [CMA]), which clears a vast majority of mergers every year. As the deal lumbered through the UK's regulatory processes, no commentator predicted that the competition authorities would be a serious bar to a tie-up. After all, a combination of Britvic's orange-coloured Tango drink and AG Barr's Orangina was probably not uppermost in the minds of the government when they drew up competition policy. Nevertheless, the competition authorities are a critical stakeholder for almost any deal – large or small – and neglecting to recognize this is dangerous.

So when the OFT referred it in February 2013 for a lengthy examination by the Competition Commission (now also superseded by the CMA), there was much gnashing of teeth as Britvic and AG

Barr complained that the market's dominant player, Coca-Cola, already had double their combined market share.

Britvic's chairman Gerald Corbett was widely quoted as stating: "If this is [UK] industrial policy, I am a Frenchman. This is about two British companies getting together to take on Coca-Cola. The winners today are cracking open bottles of champagne at Coca-Cola in Atlanta, Georgia."

Strip away the populist comments and the due diligence comes into question. Was a referral of the tie-up so completely unlikely that the companies - and their lawyers - should have made the deal contingent on quick approval by the OFT? For Britvic, which was dealing with the impact of the Fruit Shoot recall, you can see why such a contingency was particularly palatable because only a quick tie-up would get it out of its immediate troubles. But from the perspective of AG Barr, which had been presented with the opportunity of a lifetime, it is hard to see why the company would choose to put a backstop on a merger unless its hand was forced.

The two sides promised to revisit the possibility of a merger following an investigation by the Competition Commission. Britvic's chief executive Paul Moody, who had agreed to step down as part of the merger, was replaced later in February 2013 by an executive who cut his teeth in the excellent Diageo team.

The new chief executive, Simon Litherland, had been hired as Moody's successor before the A.G. Barr deal, so was now in an unenviable position. But, instead of sloping off into the sunset, Litherland kicked off a strategic review to assess how he could improve Britvic's strategy regardless of any merger. What he found were £30 million a year of cost cuts that Britvic could implement itself, cuts that had been overlooked when AG Barr's chief Roger White promised to find £40 million synergies at a merged business. In announcing Britivic's own rationalisation programme he wiped out much of the financial rationale for a deal. Having recovered from the Fruit Shoot recall, Britvic's shares were now trading at nearly 500p and the company could renegotiate merger terms.

Once the Competition Commission cleared the deal in July 2013, Britvic tried to renegotiate its share of the merged company up from 63 per cent to 70 per cent and - crucially - it asked for control of the board of the new business, reputedly with Litherland replacing White as chief executive, according to reports in The Telegraph.

The positions could not be reconciled and the two sides walked away with AG Barr professing itself "disappointed" and Britvic lauding its former merger partners as "good people" but seeing a bright standalone future.

Several years on it looks like somebody at the OFT inadvertently did Britvic and its shareholders a favour when stalling the deal and allowing it time to rethink the proposition. AG Barr's share price remained broadly undisturbed, while Britivic's shares hit a high in 2015 of 775p per share, almost three times higher than its low when the process started.

Successful due diligence has solid foundations

The building blocks of successful due diligence are solid corporate strategy and dedicated implementation of that strategy through continuous target selection. For example, US private equity house Vista paid more than its rivals to acquire failing software business Misys, but had done enough homework to know that the target had more value than their competitors realised. We will consider this case study in our next section on valuation.

Financial sponsors, such as private equity firms who each do upwards of 10-20 deals annually, are businesses who must – and do - excel at due diligence. One such company is JAB Holding Company, the private wealth vehicle of the Reimann family, whose wealth dates back to the German Benckiser industrial chemicals business founded in the 1820s. They saw an undervalued gem in Douwe Egberts coffee business in 2013 and, because JAB could see the opportunity it brought, it

bought the coffee maker ahead of rival bidders and by 2014 had co-investors including global food giant Mondelez. For $13.9 billion, JAB also purchased at the end of 2015 the US coffee company, Keurig Green Mountain.

And it's not just financial sponsors who are known for their excellent due diligence. Liberty Global, the entertainment firm stalking ITV in 2015, is known for its background research and speed, having completed the acquisitions of Virgin Media ($23.3 billion) and Ziggo (€10.0 billion) in record speed in the prior two years in terms of starting the conversation/dialogue and completing the deal.

Getting it right the Cheung Kong Way

Cheung Kong Infrastructure (CKI) Holdings has been one of the most successful acquirers of the last decade. With an investment portfolio that spans Europe, Canada, Australia and New Zealand, the company's Chairman is Victor Li, the eldest son of global entrepreneur, and Hong Kong's wealthiest citizen, Sir Li Ka-shing.

Like Diageo, CKI has a reputation for excellent target selection built on a bedrock of high quality industry expertise. Putting in the homework early helps the company through the due diligence processes that are a key part of infrastructure asset auctions.

One of CKI's biggest European acquisitions was UK Power Networks - the non-core electricity distribution arm of EDF, a French power company who had bought into the UK market with the purchase of several English electric companies including London Electricity Plc in 2002. The French power giant decided in 2010 that it wanted to be part of the UK's new nuclear power programme, but needed to divest assets in order to pay for that investment. In addition, returns in the electricity industry had been dampened by the 2009 recession and the industry was also facing regulatory issues.

CKI, who had missed out on the earlier sale of a regional electricity distribution business, brought in Basil Scarsella, a long-term senior executive of the group to run the bid, in conjunction with CKI's M&A executives, for the assets that would become UK Power Networks.

Scarsella believed that CKI's unique approach gives it an early advantage over other financial bidders, claiming that "CKI considers itself to be an operator of regulated assets not just an investor... CKI has owned and successfully operated regulated utilities assets in Hong Kong, Australia, United Kingdom, Canada and New Zealand for a long time. When undertaking due diligence on possible acquisitions, CKI generally have a very good idea of areas in the business where they can add value." This demonstrates another key point about due diligence done well: the need to know your own company's strengths and weaknesses in order to assess properly what complementary skills and resources are needed through a merger or acquisition.

The Hong Kong-based business does have a stand-out reputation for bringing in good managers, applying best in class governance and then leaving them to run the business. In that sense it is sometimes viewed as an excellent hybrid - tying the interests of the company's backers to management's, but also having a corporate level of industry expertise.

Scarsella says that CKI's status as a long-term investor is also seen as a cornerstone of its success. "The proof is there for everyone to see that CKI is a long-term investor. Reputation is very important so CKI manages the businesses from a long-term perspective".

CKI has so far largely focused on developed markets where the state has already sold off most infrastructure assets. Given the size of the pool of potential investments, maintaining this reputation is a necessity, not a luxury.

From CKI in Asia to Rolls Royce and Britvic in the UK, careful, holistic due diligence that takes into account issues such as cultural differences is vital. Adequate time must also be planned for this work: it cannot and should not be rushed.

Excellent due diligence will now become our building block not just for the next section on pricing, but, if the deal does go through, for the post-deal period where excellent due diligence provides the foundation for excellent integration.

Knowledge is Power: THE DOs AND DON'Ts

- **Do your homework; knowledge is power**
- **Do take your time – it might even help reduce the price…**
- **… but don't be afraid to move quickly if you need to as long as you have done your homework**
- **Don't forget to carefully consider non-traditional risk factors like culture, ethics and cyber security in your due diligence process**
- **Don't be afraid to walk away from a bad deal**
- **Do remember to spend time on managing all the important stakeholders as you'll have to work together once the deal is done**
- **Don't ever assume that you know everything about a target company, even if you think that you know the industry and even that company well.**
- **Do conduct due diligence on your own company's capabilities to do the deal, including the integration.**

0.5. Why the Price Isn't Always Right

Cast your mind back to the end of last century when the Millennium Bug was the world's biggest cyber threat and the world was preparing to party like it was 1999. The late 1990s and the millennial dotcom boom saw a slew of mega-deals that still dominate the M&A league tables. In 1999, the UK's Vodafone AirTouch launched an offer for its German rival Mannesmann, in what remains the biggest ever hostile cross-border bid. The deal was a totem of a telecoms boom that easily dwarfs the technology market mania of the Facebook-WhatsApp age.

At the time, a captivated global business audience followed every twist and turn of a rare Anglo-American raid on Germany company, until Mannesmann rolled over and Vodafone ultimately paid a massive $183 billion for a friendly merger. Approaching 20 years later, it remains the third-largest M&A deal ever.

Five years after the merger, Vodafone was forced to tell investors it was taking a £28 billion "goodwill" charge, one of the biggest post-acquisitions write-downs on record. The write-off was primarily due to the Mannesmann acquisition. Such a significant write-down of goodwill, defined as the difference between the net assets of an acquired business and the purchase price, indicated that Vodafone had mispriced its bid for Mannesmann.

Yet when the deal is considered – both at the time of the transaction and in the aftermath - pricing is very low down the agenda of criticisms. This may sound surprising, but it is not. Pricing is not an issue we consider to be one of the fundamental Three Big Mistakes of Deal-making; it is possible to pay a high price and still make the deal a success., And valuation and pricing, in contrast to our Big Three of planning, communication and people, are together the one area of deal-making where participants tend to invest appropriate time and resources to get right. Not that firms don't get it wrong (as with Vodafone above), but at least it typically is something that gets appropriate attention.

We will walk you through the mechanism for determining the correct valuation as determined by the buyer - that is, its walkaway price - taking in consideration methods used by the wide variety of bidders from financial sponsors such as hedge funds, private equity firms and even sovereign wealth funds to the strategic corporate acquirers, both privately-held and publicly listed.

Many of the most obvious failures of valuation occur not because there is a mistake in the valuation methodology or process, but because a buyer's view on either or both the future forecasts and risk – and therefore inputs to their financial models - is inherently flawed.

A good example is the acquisition by Saudi Arabian investors of Continental Farmers Group Plc, the owner of huge tracts of valuable fertile farmland in the Ukraine. The Saudis bought the UK-listed agricultural business through an investment vehicle - the United Farmers' Holding Company - as part of Saudi Arabia's strategic push for food security. The Gulf country, which had plenty of petrodollars but very little of its own arable land, had in recent years encouraged its state-backed companies to buy up farmland in Africa and near Asia.

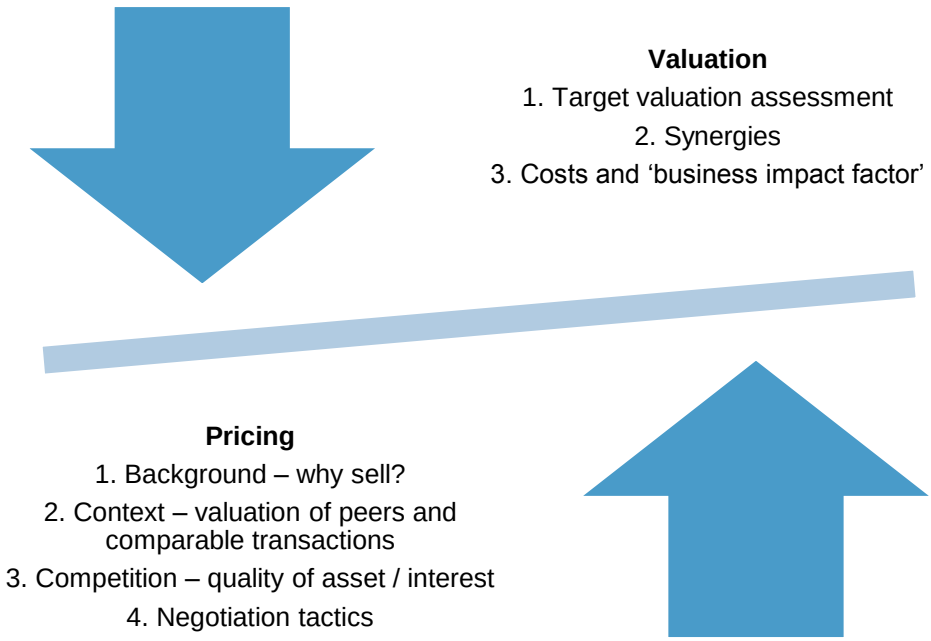
Unfortunately, when Russia sent troops into separatist, ethnically Russian parts of Eastern Ukraine in 2014, food production slowed and it became almost impossible to get food harvested and out of the country. Saudi Arabia's willingness to invest in unstable geopolitical regions - or certainly to do so for the £58 million it paid for the UK-listed company - was not primarily a valuation error or due diligence mistake. Instead, it was a strategic gamble on a bad risk, or a mis-pricing on risk if you will. Pricing and valuation must be part of a company's wider M&A strategy.

Valuation versus Pricing

M&A valuation centers around striking the balance between the buyer's views of the value of the target and the 'market' or the seller's expectations on price to be paid. In order to avoid overpayment,

the bidder should always have established their walk-away price prior to embarking on potential target pursuit.

Figure 0.5-A: Valuation vs Pricing



In summary, there are five steps to establishing a buyer's walk-away price

1) Stand-alone valuation to the equity shareholders

There are several different methods of doing this, including the target's financial performance in relation to the performance of comparable listed companies; assessing net asset value or using management buy-out / leveraged buy-out models determined by the company's financial forecast and the cost and availability of debt.

Many, if not all, valuation methodologies will be influenced by market or transaction multiples, that is, what other investors are prepared to pay for one unit (dollar, euro, pound, etc) of revenue, EBITDA or earnings of a company or its competitors. Public target bidders also need to consider the 52 week-high pre-bid target share price, as it has been shown to have an impact on the minimum bid level at which the shareholders' are likely to tender. In other words, each shareholder will have a view on the value of control, that is, the value of future benefits from the stock, and the memory of near-term historic valuations, which the premium paid has to exceed.

Interestingly, the average premium paid of 20-40 percent over the undisturbed share price in acquisitions of public targets has been remarkably consistent over time and across sectors, which is likely a reflection of the benchmark 'value' of giving up control and future benefits for investors. These premiums do vary by industry, country and point of time in the economic and M&A cycle.

2) Add: Target's net debt

Enterprise value must consider the target's debt holders as well as shareholders. There will usually be a change-of-control clause in the debt holders' contract with the target company which means the acquirer will need to pay down or renegotiate that debt after the deal completes.

Clearly, any outstanding cash belonging to the target can be used to net off the effect of the debt. This is why cash-rich companies make for likely acquisition targets.

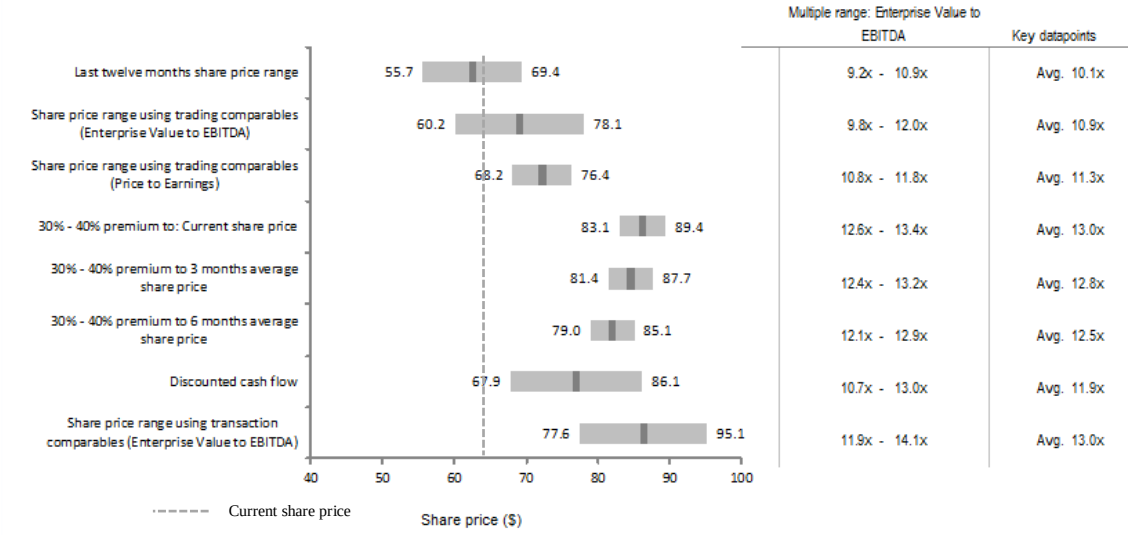
3) Add: What is control of that business worth to my business?

This 'control' allows the acquirer to achieve synergies. A synergy in this context is the notion that the two businesses are worth more together than as two separate entities. Synergies can be revenue- or cost focused, with usually only the latter making it into models and deal communication as it is relatively easier to control, to measure and to track. In some ways, synergies are also the inverse of the acquisition premium and should, at least in theory, ensure that the bidder with the greatest synergy potential prevails in an auction. However, due to several reasons already discussed in this book – hubris, strategic mistakes, poor planning, external pressures, etc. – this is easier promised than achieved. The value of acquisition synergies is also a key sweetener for investors in any share-based deal.

4) Do: Valuation analysis

There is never a single, exact answer in M&A valuation. Scenario analyses and valuation ranges based on different possible outcomes are essential. With so many subjective and moving inputs, there simply is no such thing as the right M&A value, and all the values should be considered. This point is well demonstrated by the commonly used football field format, a given in any deal pitchbook.

Figure 0.5-B: The valuation football field



If a deal is indeed agreed, the agreed price will likely end up being somewhere between the low or the high end of the range, with the exact point being determined by non-financial factors such as the relative negotiation strength of the two parties.

5) Add: Costs, including:

- Advisory costs - investment bankers, accountants, lawyers, public relations firms, stock agents, debt advisory fees, etc. (these can be up to five per cent of the negotiated deal value)
- Opportunity costs – what the company would be doing with the time and resources spent in the pre-completion phase if a deal was not being done (this is a difficult figure to estimate, but should not be ignored for that reason as it could be the highest individual deal cost item)
- Dis-synergies – when the company is constrained to achieve certain cost synergies due to its size and scale in the market; this is particularly important if the buyer expects to have to divest assets as part of the deal, either to finance it or because of competition concerns.

- Integration costs (these can be up to 15 per cent of the deal value, although spread out over several years)

Funding costs (interest payments), if bridge loans are required or if debt is being raised to purchase the target.

Clearly, there is an entire industry and many tomes devoted to a whole variety of valuation methods. But despite their very technical and apparently precise nature, the output should always be challenged on the basis of reasonability and logic. The use of valuation methods is an art, not a science, as will hopefully be clear later in this section. Just because a complex valuation method spits out a result for the target's value doesn't mean that is the correct figure at the time of calculation, in that specific deal and for that buyer.

Having a formal process to determine the walk-away price, which, as with everything in M&A valuation, will be a range as opposed to a precise number, should help acquirers recognise and evaluate warning signs in the process when the negotiation is running hard. It should help executives to have a more objective justification to the buying company's board as to why it should make a decision to walk away. Finally, if an indication of price expectation has been given in an auction, it should help potential bidders determine early in the process if it is one in which they should participate.

Of course, the walk-away price only considers the buyer's situation. Equally important is the selling shareholders' view on value, which will be of critical importance in the pricing.

In summary again, the five questions that will influence a 'market' or the seller's view on pricing are:

1) Rationale: Why do I want or have to sell?

2) Context: What have competitors sold for?

3) Control: What premium will I or my shareholders accept for change of control?

4) Competition: Can I get a higher bid from someone else?

5) Finance: What can the bidder afford and can they borrow to pay more?

The most efficient buyers will run valuation models alongside their live deal list and do tend to be stricter in their approach to valuation, that is, they should have a view when it is time to walk away, or at least be more selective in the deal process they decide to participate in. The bid by the RBS-led consortium for ABN Amro - a hurried deal with apparently little valuation planning and due diligence - is the counterpoint to that approach. CEOs who have not put in their early groundwork will find it much harder to pull out later on because at that point they and their team (including the board of directors) will be influenced by other factors. These include emotional ties to the deal: there is often a tendency to assume the target will be won and to attribute significance to the sunk costs of both time and money already invested in the deal process.

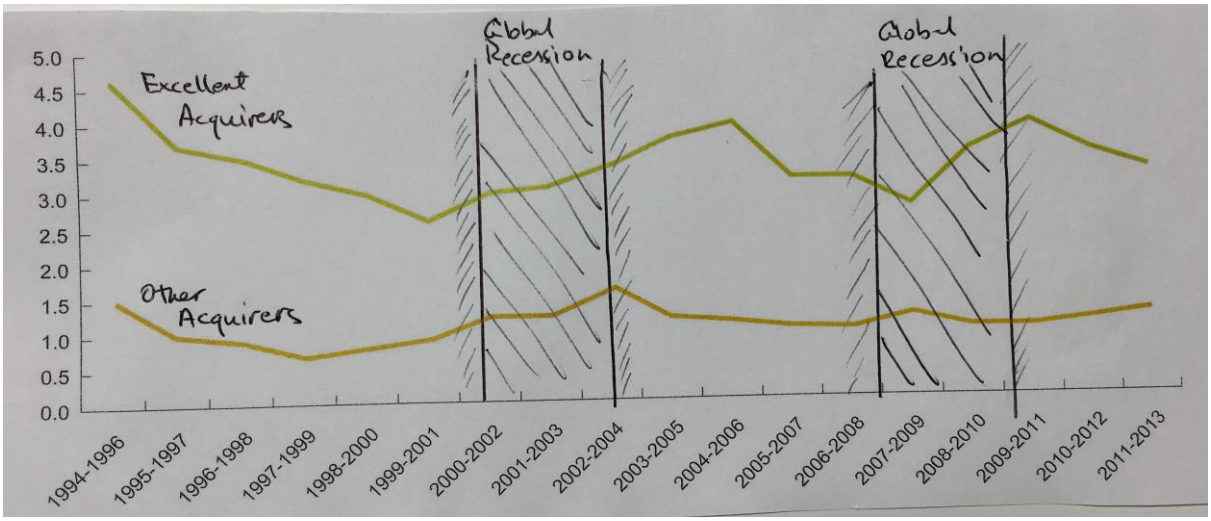
Because of this overconfidence, managers who are responsible for their company's M&A process, and have a successful track record on past deals, are more likely to embark on a "riskier" strategy. This could include cross-border transactions, which may require regulatory approval in multiple jurisdictions, or hostile takeovers.

Masters of the Deal

Despite our claim that a high price doesn't necessarily mean a disastrous deal, there is evidence that successful acquirers are price-savvy and tend to be better at 'timing the market'. Indeed, they are more likely to strike when others are encumbered, when a target can be bought for a much lower price.

According to global research conducted in 2015 by Intralinks and Cass Business School, Masters of the Deal – Part 2, more successful M&A corporates – measured by share price value generated after the acquisition(s) or divestiture(s) – significantly increase their deal value ratio of divestments to acquisitions in times when markets are 'hot' and crucially valuations are high. Similarly, they shift their ratio towards more acquisitions than divestments when markets are less inflated.

Figure 0.5-C: Buy and Sell patterns of successful acquirers



From our experience, key advantages for successful buyers also include a strong corporate culture and good preparation, both through solid long-term implementation of deal strategy and effective due diligence.

Overpaying is not the End of the World

If there is one company that reminds us there corporate second chances do exist, it's Misys, the software provider that went from an unloved public company to a takeover target in an over-priced private equity transaction. The company's owner, Vista, won a bidding war to get Misys, but paying over the odds has not held it back.

In 2012, Misys was listed on the London Stock Exchange. The company was over-leveraged, under-marketed and its shareholders were mutinying. The company's client base then, as now, was comprised principally of large international banks and financial institutions who were struggling through a Eurozone crisis that considerably weakened their willingness to invest in software.

It looked like things were getting worse as Misys reported a 12 per cent fall in revenues for the third quarter to £89 million. The company's shareholders - pension funds as well as hedge funds and other activists - were unwilling to wait years for things to get better so they supported the sale of the company, basically to anyone who would have it and who would be willing pay a reasonable price. They weren't greedy.

With each of their shares worth just 260p, investors were particularly annoyed that a deal to sell Misys to a US buyer for 450p a share had fallen through in 2011. It looked like they would now have to accept an all-share bid from a Swiss trade rival Temenos without a premium to the share price - a very unusual situation as most offers for public targets include the aforementioned 20-40 per cent control premium. However, Misys and its investment bankers managed to get a bidding war going.

CVC, the private equity house, and Value Act, Misys' biggest investor holding 21.5 per cent of the company, looked like carrying the day with a higher bid. But another private equity firm, Vista, got Misys' non-executive directors on side and made a surprising 350p a share bid at a six per cent premium to the company's share price, which had already been bumped up by CVC's bid.

US based-Vista - a technology specialist - ending up valuing the company at more than £1.2 billion, despite the fact that Mysis' revenues were falling. Analysts described Vista's price as "full" and many commentators thought the private equity house had paid a big premium that was artificially pushed up by a bidding war.

But Vista has made a huge success of Misys thus far. The US private equity house combined it with one of one of its portfolio companies, Turaz, the former Thomson Reuters business that provides software for managing treasury and capital markets transactions. Then it bolted on IND, a mobile banking software provider, and Custom Credit Solutions, which makes software for managing the loan origination process.

Vista brought in Nadeem Syad, an Oracle veteran with whom it had worked before who - thanks in part to an improvement in European financial markets - turned Misys around. At the end of 2014 Vista appointed investment banking advisors to prepare the company for a dual process sale or IPO and, according to Sky News, then had talks with a number of parties in including Temasek, Singapore's sovereign wealth fund.

What is most likely is that Vista knew and understood the potential for Misys better than anyone else so could afford to pay more than others (overpaying, in the eyes of those competitors) because it could extract more value from the business. They had done their due diligence which was then reflected in their deal valuation and thus were willing to pay a higher price.

It is not surprising that a study by Forbes magazine of 500 CFOs who had been involved in a merger puts overpayment very low down the list of why deals fail. Overpayment comes in at 7th, below incompatible cultures, an inability to manage the target and a clash of management styles - all failures that belong in the "failure to properly consider people" Big Mistake. Also rated as a bigger problem than overpayment was a failure to anticipate foreseeable events as happened with the Saudi Arabian investors in the Ukraine and with the entire global mining sector around 2007, even though in both of those industries there was evidence at the time of the possibility of a change in market circumstances.

Pricing in Risk

Failure to anticipate foreseeable events falls between being pricing risk failure and a failure of assessing underlying strategy. With the Ukrainian farmland deal, priced at a 48 per cent premium to the undisturbed share price despite falling earnings for the target company, it certainly seemed that the Saudi Arabian investors had a fundamentally different view – and in hindsight too low - on the appropriate risk discount than the rest of the market. Given that the Caucasus region has a long-standing history of Russian support for separatist ethnically Russian people in former Soviet countries, that risk should have been better anticipated in their valuation calculations.

Sometimes events that could have a huge impact on takeovers are not foreseeable at all (so-called 'black swan' events), but rarely do they come completely out of left field. There are well-developed processes in risk management of identifying possible (but not necessarily probable) scenarios, and the pricing and valuation calculations for an M&A deal should be stress tested through these scenarios.

Deals hit by potentially foreseeable changes in technology include the disastrous AOL-Time Warner merger which failed to anticipate the massive shift fast internet would create in the entertainment market, even though there were definite signs that this was the way things were moving at the time

of the merger. A number of well-known contemporary analysts were saying at the time that they couldn't understand the deal. Tom Wolzien, a stock analyst at Sanford C. Bernstein, was reported by The New York Times shortly after the deal was announced as saying that "there's a real difficult time with the Street by and large coming to grips with the combination" and that neither AOL nor Time Warner were easy to understand because AOL got its revenue from subscriptions, advertising and Internet commerce, whereas Time Warner had five major divisions, each with its own different business cycle.

The effects of regulatory reform should also be anticipated. For example, financial regulation that bans payment protection insurance or a medical regulator banning a pharmaceutical company from making a particular medicine are risks which are foreseeable. However, few blind spots have been as obvious as the one that developed amongst executives in the mining industry in 2007.

With the world on a rapid upwards economic trajectory, the years that led up to the 2008 financial collapse were good ones for most commodities. Not only were the US and Europe booming, but the fast-growing BRICs were joining the party. China and India were building new cities at a pace the miners could not match and commodity prices soared as they fought with Latin American buyers over aluminium and iron ore.

The emerging markets boom convinced Big Mining - including Rio Tinto chief executive Tom Albanese - that the industry had entered a new "super-cycle" where there would be no slowdown. Ever.

This cloak of invincibility gave Albanese and Rio's biggest rivals - BHP Billiton, Glencore and Xstrata - the confidence to go on spending sprees. The term 'super-cycle' was still being used in 2009 as the Western European and American banks begged for taxpayer bailouts, but Albanese didn't acknowledge the new reality - the need for less aluminium and iron as car production, heavy machinery and building works slowed down - until 2013, when he was pushed out in the wake of a $38 billion write-down.

Albanese had joined Rio in 2007 at the top of the cyclical commodities peak when aluminium prices were at a 20 year high. At the same time the world's biggest aluminium producer, Alcan, wanted protection from an unwanted bidder, just as Albanese's company was being pursued by its own unfriendly bidder, BHP Billiton, for a mining mega-merger. Sealing the deal for $38.1 billion - a 65 per cent premium on Alcan's undisturbed share price – was, the Rio chief claimed, "a case of being in the right place at the right time."

Former Alcan chief executive Dick Evans describes it rather differently. Evans, talking with the Wall Street Journal in 2013 with the benefit of hindsight, called it "one of the worst decisions ever, the largest metals and mining transaction in the history of the world at the high point of the commodity cycle."

Buying Alcan did help Rio Tinto to fend off an unfriendly approach from BHP Billiton, although by the time its rival formally abandoned the chase, it was November 2008, and two months after the collapse of Lehman Brothers would have made it very hard to borrow money for the deal. Regulators had also threatened to tie that deal up in months of red tape.

The Alcan deal, meanwhile, left Rio highly over-leveraged just as the world was heading into the financial crisis; overnight, the miner's net debt increased to $46.3 billion, or 94.5 per cent of turnover, from $2.4 billion, or 9.4 per cent of turnover.

Rio Tinto was not the only miner to gorge on spare cash generated by the commodities boom. Brazil's Vale bought Inco for $18 billion in 2006 and Australia's Freeport-McMoRan Copper & Gold Inc bought Phelps Dodge for $23 billion.

In fact the world's largest mining groups have written off about 90 per cent of the value of their M&A deals completed since 2007, according to a report by Citibank in 2015. The bank calculates that, overall, miners have built up impaired assets worth $85 billion over those last seven years, and this represented 18 per cent of their average asset base. Most affected were Rio Tinto, which had 34 per cent of its asset base impaired and Anglo American, with 23 per cent impairment.

Rio did the biggest deal at the worst possible time. One of the large credit rating agencies, Fitch, said it was concerned that it might need to lower the miner's credit rating. Rio was forced to go cap in hand to shareholders for a rescue rights issue. The company was then left trying to sell assets to streamline itself at a time when there were few buyers for anything, and even fewer who could afford it.

As the economy improved slowly, Rio hung on, hoping that aluminium prices would pick up. But it had misread China, underestimating that country's own growing aluminium output and overestimating demand for the metal, which was constrained by fall in sales of new cars.

The company delayed write-downs, taking only $1 billion in 2009 against the Alcan purchase, but when the hoped-for bounce failed to come, it was forced to write down a further $14 billion more against both that deal and a $3.9 billion Mozambican coal acquisition personally spearheaded by Albanese in 2011.

At this point Albanese's position was no longer tenable. "While I leave the business in good shape in many respects, I fully recognise that accountability for all aspects of the business rests with the CEO," he said in his farewell statement in January 2013.

Valuing Intangibles

In addition to strategic errors in judgment that lead buyers to mis-price risk, there is also a category of "true" pricing errors where a buyer has attached a value to a target's asset, but has under or overvalued it, or - even more worryingly - not recognised it as an asset.

It is hard to imagine that despite the value in most businesses these days being derived from intangible sources, these are neither identified nor audited in financial statements. It is only in M&A transactions that they even appear on "the books" and even in a transaction situation, the allocation of purchase price will ascribe value to those easy to identify intangibles such as registered IP rights but then gather most of the value together in one word, 'goodwill'. For reasons that should become apparent, we are predicting the death of goodwill, at least in accounting terms.

In a world increasingly driven and dominated by disruptive technologies, the issue of careful assessment of truly valuable but more or less identifiable assets and intangible intellectual property [IP] is an increasingly important issue in M&A. Badly managed in a transaction, IP can be a quagmire that can adversely effect any M&A deal, as we saw in the last section when VW acquired Rolls Royce only to discover it had not bought the rights to use the luxury carmaker's name. VW's error is not a one-off: equally famously eBay bought Skype for $3.2 billion and seemed not to recognize that the core Skype technology relied on a license from an entity outside of the transaction perimeter which then expired after the purchase.

In the past, IP evaluation has been limited to black letter registered IP rights, that is, patents (particularly important in the life sciences industry), trademarks, design rights, domain names and copyrights.

Because of this, IP due diligence has traditionally been carried out by law firms. During the due diligence phase law firms will focus on the IP that can be easily seen and therefore assessed and will typically:

- Ensure the target owns or has the right to use the registered IP that comprises part of the sale (in an assets sale) or is owned the target (in a share sale) and verify, quantitatively, that this registered IP exists
- Check the impact of change of control on the registered IP
- Establish whether there are any pending legal challenges to the target's registered IP or infringements of 3rd party registered IP rights by the target and aim to establish the risk in both cases
- Negotiate warranties from the seller to confirm the above; sometimes this will be done instead of due diligence rather than in addition to it.
- The buyer and its advisers will seek to value the assets acquired and allocate value between the tangible and intangible assets acquired.

Valuation of IP is normally carried out post sale using one of the three main methods:

- Cost: what would it cost to replace the IP asset based on benchmark figures? The challenge here is that benchmarks are not always available and, even where a buyer or advisor suggests that they are, upon further due diligence, the IP assets are often found to be unique in ways that make benchmarks difficult to use as accurate comparables
- Market: how much would it cost to buy a similar asset? Similar to the issue of benchmarking availability, the uniqueness of both IP assets and individual M&A deals can make it difficult to identify a similar asset and determine its value
- Income: how much revenue will the asset provide once it is owned? This calculation can be based on the alternative cost of licensing the IP from a third party or based on an estimate of the additional profits generated by the target business versus the profits of that business without the IP. This income estimate can then be projected for, say, the next five to ten years and, using net present value [NPV] calculation techniques, modelled to determine a current value for the revenue stream

In recent years, however, there has been an acceptance that there is significant value in other "intangibles" that extend beyond the scope of legal IP due diligence.

Andrew Watson, Head of IP Strategy at Ernst & Young says: "The main challenges with intangibles and IP are that there is no consistent lens used to assess which intangibles are the most important sources of value and no common language in which to talk about them. It is typical to find that after the value of tangible assets of the target are deducted from the purchase price, as much as 95 per cent of the value will be intangible. Take off the value of the registered IP rights using a method such as relief from royalty and there is still a large amount of value that will typically be allocated to "goodwill". If a buyer does not have an appreciation of all of the assets being acquired and legal diligence does not, in fact could not, identify and assess them, there has to be a serious risk of impairment to goodwill."

Within this goodwill element are many assets of different shapes and sizes. A company's people - executives and staff - are the main repositories of that intangible value. The most valuable asset of most companies will be its knowledge of what to do and indeed what not to do (a right known as negative know-how); expertise on how to build or take a product to market on the one hand and supplier relationships on the other are other intangible assets examples of this. Such knowledge is rarely able to be underpinned by formal legal IP rights such as by patent or trademark protection. In fact, a well thought through IP strategy would deliberately decide not to apply for registered protection of these assets.

The main exception to the rule that most value is in the unregistered IP rights is in the life sciences sector. In pharmaceuticals the majority of intangible value will be in the patents which give a right to exclude a competitor from using the same invention for 20 years. In this industry, the patent cliff will

apply at the end of the patent life, at which point 80 per cent of the revenues will typically disappear within two weeks and never come back. , However even in this sector, other intangibles such as expertise in compliance with regulatory approvals or R&D collaborations will exist and be of high value.In terms of our Three Big mistakes of Deal-making, valuation mistakes are often fundamentally people mistakes. If staff and executives hold the keys to intangible value that is not underpinned by formal IP rights, then a buyer should find ways within the transaction structure both to unlock and to transfer that value and incentivise the holders to stay. Buyers must be careful to ensure that where they think they see no value in an incumbent management team, the intangible value of the company is held elsewhere in that company, for instance by lower level executives or a group of staff such as an R&D or Marketing team. The key, first, is to identify and evaluate the asset base. The solution as to how to deal with this in the transaction context then depends on the nature of the specific asset.

Even when a buyer does put value on the senior management team, it may often not do enough to persuade them to stay with the business post-deal completion. A case in point is HP's acquisition of Autonomy, the 2011 deal we discussed in the Preface to this book. At $11 billion, or 24 times EBITDA, HP's valuation of Autonomy was a stretch by any definition. At the time of the purchase it was widely believed that HP wanted Autonomy not just for its software, but also for its dynamic management team, led by serial technology entrepreneur and founder Mike Lynch. The desire to keep management on board was believed to be a key reason for HP's willingness to pay such a full price.

This made sense because Lynch and the Autonomy senior management team were repositories of much of the intangible and therefore total value of the company. It was objectively clear and would make IP strategic sense for Autonomy's IDOL engine search technology to be protected not by patents but by trade secrets (why would one patent and therefore make publicly available a search technology when it could not ever discover infringement by a third party?). It is likely the case that when HP conducted its IP diligence, it analysed Autonomy's patents and other registered rights. But - as with a growing number of newer technology businesses – Autonomy's IP value was not just in its patents but in its trade secrets. Apparently around 600 of them. And who has access to trade secrets in a company - the senior management team of course

IP Due Diligence Advice Trends

A specialist team at Ernst & Young and in other advisory firms have been identifying these trends and beginning to fill this gap. Rather than replacing the traditional law firm due diligence, these advisors will work alongside the lawyers performing qualitative due diligence on IP and intangible assets to back up the legal diligence.

Andrew Watson of EY's IP Strategy team, who has also previously worked as an M&A lawyer, has created what he calls a "universal taxonomy of intangibles". This is used to help buyers identify all intangibles and then, using an associated methodology, establish which are the most important intangible in driving value. This analysis feeds into the valuation exercise required. "We place a lens over a business to work out what is really at the source of value. Outside of life sciences most companies could lose most of their patents and it would make little difference to its success. We need to look outside of the registered rights using a new lens to find that value. Often it may be a team of highly regarded men in white coats (literally) who are able to design products to meet the requirements of the future product roadmap".

The system was created with data from over 300 projects where the commercial value of IP was assessed. Watson and his team built this into a benchmarking system for intangibles, whose core data is constantly added to. As Watson says "this is a brave new world".

Another example is Microsoft, the company that changed the computing world with its Windows software. It has not had a happy time in the M&A market.

One of its biggest deals - and the largest in terms of people and plant - was its acquisition of the handset division of Finland-based Nokia, another once great tech giant on the slide.

In 2013, Steve Ballmer, the same Microsoft CEO who dallied with Yahoo, decided the IT giant had to get into the mobile phone business that was fast becoming the principal technology that people were using to access the internet. A deal to buy Nokia's handset business for $7.9 billion closed in April 2014, but just 15 months later Ballmer's successor, Satya Nadella, announced a $7.6 billion write-down of Nokia's assets and axed 7,800 staff from the company. That's $7.3 billion written off in just over a year.

In the years leading up the deal, Microsoft and Nokia were both victims - to a greater or lesser degree – of all-conquering tech giants Google and Apple. Nokia had been hit much harder. With its business squeezed between Apple's iPhones and rivals who ran Google's Android on their handsets, the Finnish business was losing money as it stuck by a deal with Microsoft to use its once dominant Windows operating system on its mobile devices.

Microsoft's performance had held up much better than Nokia's thanks to its Windows computer software, which, although it had lost ground to Apple products in home computing, had held up in the business market. But in the long-term, Microsoft saw its future threatened by the increasing demands of customers for synchronised information on all their devices. The company knew that people wanted to be able to start an email on their laptop and finish it on their phone, Microsoft would only be in the game if people bought Windows-based handsets.

In the wake of rumors that Nokia was about to ditch Windows in favour of the more widely used Google-developed Android operating system, Ballmer announced the acquisition of Nokia. The problem was, by the time he made his decision, the ship had well and truly sailed. Very few consumers were convinced by a Windows-based phone; just three per cent of mobiles globally used the operating system. Microsoft had completely misunderstood the value of the Nokia handset business to its overall empire and bought something that was nearly worthless.

The acquisition was bad news for both sides. Microsoft said that it would concentrate on its core business customers, leading many analysts to ask why it didn't buy Blackberry, the businessman's favourite mobile phone at the time, instead of Nokia. The company has also concentrated on developing holo-eyewear and other devices it hoped would make handheld phones redundant in a generation. Embattled Nokia meanwhile did get some cash for its shareholders, but many of the job cuts fell on Nokia's Finnish plants, causing an outcry in the Nordic nation where the mobile phone pioneer was once a national champion and according to The Economist, contributed a quarter of Finnish growth from 1998 to 2007.

Deals Leak

As we discussed in the last section, research shows that the longer due diligence goes on, the lower an offer price is likely to be. A seller's best option to limit due diligence is to orchestrate a competitive bid process from the outset. Another pricing tactic – albeit not as openly discussed – is to leak news of the deal.

'When No One Knows', a November 2013 study on pre-announcement M&A activity by Cass Business School and Intralinks, found evidence to suggest that many, if not most, deal leaks are deliberate. The research data suggested that there is no corollary between a specific event, such as the opening of a deal-room or the hiring of advisors, and the timing of leaks. Instead they tend to appear towards the end of the process and are likely to be motivated by one party being unhappy with how negotiations are progressing. Information is therefore leaked to push the deal in the direction they prefer. In our experience, even if the leak itself is not deliberate, then the target deal team's decision whether to confirm the deal talks "off the record" can be.

In a related annual study of leaks, Intralinks and Cass found a slight drop in the number of deals showing suspicious trading activity prior to deal announcement from approximately forteen per cent of all public deals in 2008 to six per cent in 2014. Notably, through most of that period, they are also more common in Europe and the Middle East than the US, perhaps due to greater enforcement of rules prohibiting leaks in the US through much of that period.

A leak has advantageous consequences for valuation because it may start the clock on formal take-over rules, if any, thereby putting pressure on buyers. It also flushes out potential counter-bidders. Even the whisper of a counter-bid might be enough to encourage a confirmed buyer to move more quickly, perhaps short-cutting the due diligence process that could uncover additional information about the target.

It is not difficult to see why leaks are part of the deal tactic toolbox. Our research found that leaked deals deliver on average a significant increase in takeover premium of 18 per cent.

How to Pay

Most buyers will have a broad idea of how they plan to finance a takeover by the time they get to the valuation phase. But it is only after a buyer has ascribed a final price to pay that the fine details can be filled in.

In the private sphere and for smaller- and medium-sized companies, especially family-own firms, most takeovers are paid for with cash, funded by existing funds, debt or a combination of these. In the listed world of large global corporations, it possible to make an “all-paper” offer where the buyer pays solely with its own shares, although in practice most takeovers are funded with at least an element of cash.

A company’s individual circumstances, the logistics of the deal and its appetite for risk will influence the proportional mix of funding. Specifically management and its advisors will consider:

- The detail of the transaction including its financial and dilution impacts on its existing equity shareholders, earnings and share price.
- The deal’s impact on the company’s financial stability and security. The company will want to assess the long-term impact of financing on its income statement, cash flow and balance sheet, including the ability to refinance the debt.
- How important it is to get the deal done quickly and confidentially, as cash deals can usually be faster than share or complex hybrid deals.

Of course, all are strongly influenced by the negotiation process in terms of what the buyer will accept or believes the shareholders will accept.

When a company wants to include an element of cash in the acquisition price, and it is not using existing funds available on the balance sheet, it has broadly the following options:

- A listed entity can issue new equity to existing shareholders or place equity with new share-holders. If a company is private, it might even go public to raise cash for acquisitions. Face-book, for example, bought WhatsApp in 2014 for $19 billion shortly after going public itself, paying a significant portion in cash.
- Sell corporate bonds or take on new debt from a bank or other lender.
- Sell a piece of the existing business to help fund the acquisition. We saw this with Diageo, who disposed of its non-core food assets, such as Burger King, in order to fund an acquisition spree. But the disposal doesn’t have to take place before the purchase of the new company, as buyers can use bridging finance for the initial acquisition with the plan (or even the formal

agreement already in place) to sell off non-core assets after the deal. For example, commodities and trading giant Glencore sold off Dakota Growers Pasta, a pasta-making business, soon after its takeover of Xstrata.

- Sometimes payment can be also staggered, deferred or linked to performance criteria. This a common consideration technique for smaller and medium sized businesses which is growing quickly. The acquirer will look to de-risk the purchase price by linking future growth to the payment terms. The price paid can also include a 'lock in' element for key management and staff that encourages them to stay by prohibiting them from working for a competitor for a period of time, typically two years. One issue with linked payments is that true integration is then somewhat limited. That's why it is used more widely in strategic bolt-on acquisitions or private equity backed transactions, as we will see with the case of Mergermarket Group.

In some instances, a seller can also provide its own financing for a purchaser. This is especially common in financial services where banks selling off their divisions in the wake of the financial collapse provided so-called "stapled" finance to prospective buyers whereby the financing and sale were part of the same deal – 'stapled together'.

Tax, economic climates and changing investment practices have also had a huge influence in M&A deal financing. In the 1980s 'cash was king', while the 1990s saw mega-deals such as when the large UK-based oil company BP purchased Illinois-based oil company Amoco with shares. Then, in the run-up to the global economic collapse, the easy availability of cheap debt meant share deals were rare; when the money supply dramatically tightened after 2008, all-paper (equity only) deals were suddenly back in vogue.

All-paper offers can allow a bidder more flexibility in a hostile situation because - as long as the share exchange ratio is skewed to the buyer's advantage - such approaches are relatively low risk.

Acquisitions that are funded principally by shares are more likely to be 'timed', that is, announced at a time when the bidder's shares are considered to be highly or 'fairly' valued. A belief certainly persists amongst some experts that takeover bids using equity destroy value for shareholders which is confirmed in numerous studies from the 1990s and early 2000s. Warren Buffett, an investor in Kraft, publicly advised the food group's CEO Irene Rose Rosenfeld that she was using too much of what he considered to be Kraft's undervalued stock in its 2009 bid for Cadbury.

However, a recent study is challenging that conventional wisdom regarding the impact of funding in acquisition success. Crucially, this study found that not only are share-financed acquisitions not value destructive, but that the type of funding used for a takeover generally makes no difference to its financial success or failure. 'Do Stock-Financed Acquisitions Destroy Value? New Methods and Evidence' by three academics (Andrey Golubov, Dimitris Petmezas and Nickolaos Travlos) in 2015 found no evidence for the over-valued equity hypothesis. "Stock-financed acquisitions are not value destructive and the method of payment generally has no further explanatory power in the cross section of acquirer returns," the authors said.

No doubt the topic of valuation in M&A will continue be an area of focus for professionals, and rightly so. With changing industry dynamics and the upward trends in deal-making, both in terms of number of deals and aggregate value, we will continue to see new tools for valuation developing as well as new and innovative ideas for deal financing. Valuation and pricing in this context will continue to be debated and this is precisely the dynamic that enables deals to happen. In other words, the valuation gap between the buyer and the seller is what creates the market, and although they use the same or similar methods and models to get there, inputs, forecasts and expectations will differ, hence our belief that there is no such thing as the 'right price'.

Valuation gaps can be bridged by other levers, such as speed to completion, deal terms and financing. It is certainly not unheard of that the highest bidder doesn't always win the target. Money, it

appears, isn't always everything. And while risks can equal rewards, the analyses supporting those calculations must be backed up by exhaustive due diligence, examining both the target company and external factors such as disruptive technologies, market trends, likely competitive responses and, where necessary, socioeconomic factors.

With all these moving and subjective parts, we contend that paying a price well above market expectations does not need to be fatal for the outcome of a deal, as long as the Big Three are carefully considered, although the job is certainly made easier by not overpaying.

Why the price isn't always right: THE DOs AND DON'Ts

- **Do carefully consider your walk-away price, and be willing and prepared to walk!**
- **Do link your due diligence with your valuation, including for the difficult-to-value intangibles**
- **Don't let the other side be better prepared**
- **Don't pay out all your synergies by offering too high a premium**
- **Don't forget to consider all your costs associated with the deal**
- **Do plan for the financing of the deal early and spend time striking acceptable terms for both the buyer and seller**
- **Do remember that overpaying is not necessarily an insurmountable obstacle, but can make the ultimate success of the deal more difficult**
- **Don't forget that M&A valuation is an art not a science: values and pricing differ in each deal**

0.6. Negotiating Tactics

If you were watching the 1987 film Wall Street - or any other Hollywood movie about a corporate takeover, actual or imaginary - the deal negotiation phase would come very near the start. For a non-business audience, this section is where this book would begin.

In the real world, we've had to have four sections of strategy, planning, due diligence and valuation to get to this point in the deal. It is in this section that the groundwork put in on long-term strategy and target selection combine with the heavy lifting on due diligence and valuation finally start to pay off. Of our Three Big Mistakes of Deal-Making, it is the people and planning categories that must be tackled in this section.

The single factor that distinguishes the best buyers from the rest is their willingness to invest large amounts of leadership time, money and organisational focus into a deal. What that buys is knowledge and expertise. And the old adage that knowledge is power has never been more true than in M&A. This is also true for the management team and shareholders on the 'sell side' of the deal: for selling shareholders and management teams, the single best indicator of how serious the buyer is the involvement of senior management on the bidder side.

We will consider one deal - Malcolm Glazer's acquisition of Manchester United Football Club in 2005 - that showcases this principle perfectly. But we will also see, in Microsoft's failed bid for Yahoo in 2008, that even the most intimate industry knowledge will not deliver if the negotiation tactics are wrong.

We will also see that every deal is unique. Even the best negotiating tactics are non-transferable: the blitzkrieg shareholder offensive used successfully by Shire in its all-share pursuit of Baxalta, would not, for instance, have worked for Glazer's all-cash leveraged buyout of Manchester United. Indeed, Glazer's strategy to buy Manchester United was very different from the way he negotiated and purchased the Tampa Bay Buccaneers US football team years earlier.

Given the specificity of every deal, there is little point in having a fully worked "M&A Playbook". Basic principles that can be applied to each individual deal are much better, but awareness of the options available remains critical and will be covered here.

Friend or Foe?

The starting point for any negotiating strategy is to determine whether a deal is friendly. Because unfriendly approaches of public companies dominate the headlines, it is easy to forget that 97 per cent of M&A deals start by mutual consent. Assuming you are operating in that overwhelmingly friendly majority, the skeleton approach should be to:

- Clarify where the two parties stand
- Identify resistance points
- Find zones of agreement
- Determine the best possible solution for both parties, creating a win-win

Auctions: does the highest bidder always win?

Many sellers, particularly since the arrival in force of financial sponsors such as hedge funds and private equity firms, conduct their disposals by auctions. Therefore, it is worth making a few general points here about the auction process and bidders' reputations.

Whilst an auction may seem like a cut and dried financial mechanism, it should be kept in mind that the following can also guide a seller's choice:

- How successful have the buyer's previous deals been?

- What is the buyer's history in dealing with target managements?
- Are there a large number of issues where the buyer is likely to take a position different than the seller?
- Has the buyer backed out of previous deals, either entirely or to renegotiate significant points?
- How involved and visible are senior and key decision-makers?

Does the buyer have access to sufficient financing?

As this checklist shows, sellers evaluate bidders' approaches and abilities in deal-making. Therefore, acquirers need to be very mindful of their reputation, especially private equity buyers who regularly participate in auctions. As we will see with the sale of Mergermarket Group, an auction that attracted 50 interested parties in the first round, gaining a competitive advantage through more than your formal, written submitted bid can prove crucial.

Although a longer due diligence process is positive for the buyer as it could give them more ammunition to negotiate down the purchase price, this is a less-than-ideal scenario for everyone. The better option is for bidders to have done significant research and to be given access to enough information pre-bid to provide a bid that they can stick closely to throughout the negotiation process.

For the seller, if their business is in order, the financials stack up, and there are no skeletons in the closet, there should be no reason to give away any discount in pricing or terms. This way, the final price should and possibly will match the initial expectations, pleasing the seller and making their acceptance of the offer more likely. Similarly, the bidder will win the prize without getting a reputation for a negotiation strategy that appears to outsiders as one that is continually 'chipping away on the price'.

In the small percentage of situations that are not friendly – that is, the three per cent that start off unsolicited (although less than one per cent of deals end up without a recommendation to sell from the target's board) - the negotiating strategy will be determined by a range of issues including:

- What you want to do with the company?
- How much - and how - you are paying for it?
- The stance of the target's board and its investors (and these two may differ)
- Whether the company has any other alternatives, as a desperate seller is very different from a reluctant one.
- Whether the company has any defensive anti-takeover protections to defer bidders or make a hostile purchase unreasonably expensive (some of these are called 'poison pills' when particularly offensive to any bidder)

For instance, should the buyer need to persuade the target's board to recommend the bid, the buyer will take a different approach than if it plans to go hostile by ignoring the board resistance, go around them directly to the shareholders to get their approval and then ultimately sack the board once the deal is done.

It's not just about shareholder approval, however, as the buyer will need to consider how to pay for the target. The main reason truly hostile bids – that is, those made via a formal offer to shareholders in the face of stated board opposition - are so rare, is that lenders will not often not back them. A listed company making a share-based offer has much more freedom in this regard than a financial sponsor or private company who only has cash to offer.

It isn't uncommon for a private companies to offer themselves for sale but at the same time prepare for a public listing. This is known as a 'dual track' process and the two different outcomes compete with each other.

In this context, most so-called “hostile” bids are actually “Bear Hugs” - a mechanism by which bidders bypass the board initially and target investors directly with attractive offers (the ‘hug’), usually with an offer premium that is above the industry average. No serious bidder will take this route unless they have funds - and the will - to bring shareholders around though a combination of charm, logic and cash, plus a threat and ultimately a willingness to go hostile as a last resort.

Hard or Soft?

The style of the negotiations as opposed to the substance of the approach will often be determined by the advisors - lawyers, accountants, public relations (PR) firms and investment bankers - who will usually take the lead.

Good quality advice is crucial. An independent series of studies between 2013 and 2015 by academics at the University of Surrey and New York University’s Stern Business School found that companies represented by the world’s largest multi-national investment banks and the large accountancy firms were more successful with their acquisitions than those who either had no advisors or advisors not in those groups.

Some CEOs insist on the involvement at those advisors of particular individuals they like or trust. For example, when Cadbury was being stalked by Kraft, the company insisted on using certain senior managing directors and partners at the banks and law firms advising them; another example is Invensys, the engineering firm, who preferred to rely on the same advisor for each of its deals.

There are also market-leading “stars” at some investment banks, with larger than life personalities. Such bankers are something of a dying breed, but those still practising tend to make their way onto the biggest deals, as was the case with the Kraft / Cadbury deal where, for example, the partner advising confectionary giant Cadbury in 2010 from law firm Slaughter & May was selected to be the firm’s overall managing partner six years later in early 2016. Another example from that deal was Bruce Wasserstein.

“Bid ‘Em Up” Bruce

Bruce Wasserstein, of Franco-Anglo-American investment bank Lazard, epitomised flamboyant investment banking, using every lever - however aggressive - to secure a deal for his clients. There is no doubt that “Bid ‘Em Up” Bruce, as he was known to many of the industry, who died in 2009 whilst in the middle of advising Kraft on its takeover of Cadbury, was a Wall Street legend who shook up deal-making in the 1980s.

Perhaps more than anyone, he symbolised private equity’s determination to get its target, advising KKR on its ground-breaking take-private of the fool and tobacco company RJR Nabisco, a deal that heralded the rise of financial sponsors and that was infamously detailed in the book “Barbarians at the Gate” by Brian Burrough and John Helyar and later a movie by the same name starring James Garner as the CEO and president of RJR Nabisco.

Wasserstein’s personal financial success in deal making also helped to seal his reputation - he sold his boutique advisory business Wasserstein Perella to Dresdner Bank at the height of the dot-com boom for nearly $600 million.

According to Forbes magazine, which put him on its cover, Wasserstein “did more than anyone else to modernise investment banking by bringing aggressive tactics to a world previously known more for its clubbiness than its sharp elbows.” He also fell out with lots of people, including his own partners. His public rows with Michel David-Weill, a descendant of the founders of Lazard - with whom he disagreed over his plans to take Lazard public - provided as much newspaper copy at the time as his takeovers.

Unsurprisingly, Wasserstein hated his own 'bid 'em up' soubriquet. Aside from the RJR Nabisco takeover - which was a financial success, but loaded the target with debt - a few of the $250 billion of takeovers he advised on turned out to be disasters, including the Time-Warner AOL deal discussed earlier in this book.

Wasserstein's passing was much mourned. His former partner, Joseph Perella, called him "a rare talent". He certainly transformed Wall Street, pushing the envelope with creative legal interventions, direct approaches to shareholders and the active use of public relations.

Not everybody liked his style. With the global credit crunch came an expectation of corporate austerity together with disapproval from the press and public of sky-high investment banking salaries; a much quieter style of banker seems now to be in demand, certainly in Europe.

A Football Master-Class

Malcolm Glazer's acquisition of London Stock Exchange-listed Manchester United is a master-class in how to pick off an unwilling target.

In 2003, Manchester United was one of the most successful football teams in Europe with a history that gave the club a uniquely popular global fan-base. Entertainment giant BSkyB had seen the potential for a combination two years earlier only to see regulators stamp on its bid and the fans taking credit for launching a public campaign to stop Rupert Murdoch, the owner of BskyB, from successfully buying the club.

It was a time when a number of outside investors saw the UK football market as an attractive investment either for prestige or money. According to The Glazer GateKeeper written by Teshin Neyani, others such as Russian oligarch Roman Abramovich (who purchased Chelsea Football Club) had already dismissed Manchester United as too difficult to buy and too costly. But Malcolm Glazer, the owner of the Tampa Buccaneers - an American football team - relied on his sports industry knowledge to identify extra value in Manchester United.

As we saw with Vista Equity Partners' acquisition of Misys, the Glazers believed they knew better the industry than their rivals. The family felt that the global marketing potential of Manchester United - and, more broadly that of the UK's Premier League - was vastly undervalued.

Manchester United supporters publicly and vociferously hated the acquisition. In the run-up to the global financial crisis it became a cautionary tale against the growing use of debt in buyouts: the Glazers paid £812 million, including transaction fees, to buy United, yet put in just £240 million of their own cash. Whether by luck or by good judgment, the club at the end of 2015 was valued at almost £2 billion and Malcolm Glazer's children were taking £15 million every year in dividends from the investment. Not a bad return.

So, how did they negotiate their way to such a great investment? Good industry knowledge and target selection took them part of the way, but their negotiating tactics really made the difference. The family and their advisors knew that they were dealing with an unfriendly scenario with a target that had no desire to be purchased. After all, why would the board of Manchester United want to facilitate the sale of a successful business, losing their own jobs in the process? Since the terms of the Glazer's financing would not allow him to make a formal hostile bid for the company, he put the company into a "Bear Hug".

In such a situation, sweeping up the market for available shares and building up a small initial (so-called "toe-hold") shareholding are frequently used tactics combined throughout with the Glazers' effective use of UK company law. They began to purchase shares in the company in March 2003 with small incremental stakes. Only six months later, in September 2003 when the Glazer family hit a regulatory threshold, did they declare their holding to the public, as required.

By the end of the year, they had amassed over 14 per cent of the shares from market sweeps and smaller shareholders, but only in February 2004 - when they were fully prepared - did Glazer announce that he was considering a bid for the company.

By November of that year the Glazer family had 28 per cent of the shares and then demanded – and received – three board seats. At this point, however, Glazer was nowhere near being able to force through a deal. And the rest of United's board was still firmly against it.

But Glazer had a trump card in his negotiating strategy. United's second biggest shareholder with 29 per cent was Cubic Expression, the investment vehicle of two Irish financiers and horse-racing buffs J.P. McManus and John Magnier. They also had a board seat. Combining his stake with Cubic's would give him more than 50 per cent of the club – certainly enough for control and also sizeable enough to try to force out small investors.

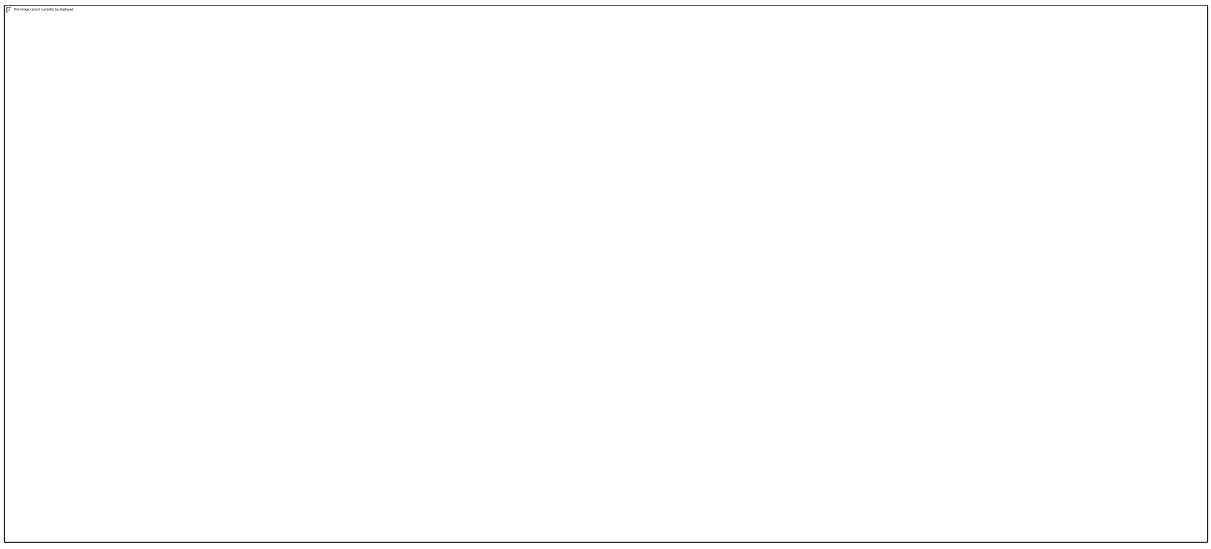
As luck would have it, the two Irishmen had fallen out with Manchester United's longstanding manager and the company's most important member of staff, Sir Alex Ferguson. The Irish financiers had gifted Sir Alex part-ownership of Rock of Gibraltar, a champion race-horse, but when the football man also claimed the stud rights to the animal, a huge falling-out ensued with Sir Alex suing and the Irishmen asking questions publicly about the financial probity of his transfer dealings for the club.

Between October 2004 and May 2005, the Glazers shifted into gear, making a series of incrementally rising indicative offers for Manchester United. But, in addition to receiving threats from fans (who themselves were trying to arrange a shareholding position to stop Glazer), they had still not secured the board recommendation they needed to take control.

In May 2005, they finally secured Cubic's stake, giving them a majority of the company's shares. Even then, while the Manchester United board advised shareholders to accept the offer on value grounds, it refused to recommend the bid, arguing that Glazer's highly leveraged takeover would be detrimental to United's wider group of stakeholders including staff and fans.

Only at this point though - confident that they could "squeeze out" the remaining shareholders as would be possible under UK takeover regulations - did the Glazer family launch a formal bid for Manchester United. Given the profit they have made from the club, the wait was worth it.

Figure 0.6-A: Glazer's Manchester United takeover timeline



Microsoft's Search Engine bid

If there is anything the media enjoys more than a football takeover, it's a Silicon Valley merger. Like the Glazers' bid for Manchester United, Microsoft's 2008 offer for Yahoo was played out in the full media spotlight. But although Glazer's clearly paid a top price for Manchester United, Microsoft's bid was about really big money in what the market calls a 'mega-deal': valued at up to $50 billion, it was merger games on a massive financial scale.

Just as the Glazers ultimately did, Microsoft opted to put Yahoo into a Bear Hug. But in this instance - despite offering to pay 61 percent more than Yahoo's undisturbed market value – Microsoft failed to come away with its prize.

It is worth saying from the outset that Microsoft ultimately got lucky. Yahoo signed a much less lucrative search and co-operation deal with Microsoft just one year later. Almost a decade later, its share price was still largely unchanged from the Microsoft bid price.

Not only that, but Microsoft has not had a happy time integrating some of the companies it has been able to buy and Yahoo would likely have been particularly difficult in that regard and might have destroyed any value there was. For example, before it bought Skype in 2013, its biggest deal was the acquisition of aQuantive for $6.3 billion. Microsoft has since written off all but $100 million of the value of that purchase.

These failures go to Microsoft's broader corporate and M&A strategy. In terms of negotiating tactics, Microsoft missed the opportunity to attempt what it had calculated as a deal worth paying for. Perhaps, like the Glazers, Microsoft saw something in Yahoo that few others could.

Carl Icahn, the activist shareholder who tried to push the Microsoft deal through, was the forerunner of a host of activist investors at Yahoo; indeed Yahoo has continued to be the subject of takeover speculation as well as a target for other arbitrage hedge funds ever since.

Icahn's actions were central to the Microsoft deal and whilst not sufficient to push it through, are representative of the rise of the activist investors. From the perspective of Yahoo's shareholders - who saw their company go through years of turmoil after the deal collapsed and who have seen its strategy drift ever since - the failure of the deal was a disaster. But let's assume for our focus here on negotiation that the merger could have been good for both companies and consider what went wrong during that crucial negotiation phase.

Keep Your Friends Close and Your Enemies Closer

The technology industry may seem international, but can really be very local.

The Silicon Valley hub that produced Yahoo, Microsoft, Google and Apple is actually a relatively tiny close-knit community - chief executives have often worked together, almost always know each other personally and certainly regularly meet at industry events. In early 2008, Microsoft CEO Steve Ballmer was still working in the shadow of the company's larger-than-life founder Bill Gates who did not depart the firm as an employee until after the Yahoo saga. Ballmer was facing a changed world dominated by Google, which was the run-away leader in internet-based computing. To tackle Google's dominance, he needed to make quick in-roads into immediate revenue growth in paid for search and display advertising. In the medium term, Microsoft also needed to protect itself against possible future threats by Google to its core Windows product.

Yahoo meanwhile was on a downward trajectory, but was still a reasonably sought after partner. A tie-up seemed like an obvious solution for both companies. Not only that, but Yahoo's shareholders - corralled by Carl Icahn, who had a small stake in the search engine's business - were keen to arrest their company's slide.

Given the closeness of the industry, you would expect Ballmer to have known his target and its executive personalities well enough to pitch a deal right. If he was unsure, he might reasonably have been expected to put out some board-level feelers before making a public approach.

Instead, on February 1st 2008, Ballmer made an unsolicited $44.6 billion approach for Yahoo. Press reports claimed background talks had been going on between the two sides for more than a year and - with the initial bid going in at a fairly full price - everyone expected the deal to happen. Instead, after ten days deliberation, Yahoo's board rejected the deal.

Yahoo's response ten days later to that initial indicative offer was the standard one that it 'substantially undervalued' the company, although it is notable here that the market did not agree; the bid was well above Yahoo's share price and, when Microsoft walked away, the company's share price fell by a third. Media reports said this was simply an opening gambit and that Microsoft was prepared to bid as high as $50 billion. But Microsoft never did make a second, higher offer.

Yahoo claimed as well that the bid was a 'significant distraction' yet within a a few days began looking for a 'white knight' by publicly cosying up to Microsoft's arch-rival Google as well as Rupert Murdoch's News Corporation. Trying to get rival bidders involved is a standard tactic for targets to get a higher price or to flush out more bidders, but in this case, in a bell-jar industry, it caused some seriously ruffled egos at Microsoft. Anyway, within a month, on March 11th, News Corp walked away,

Had it been a bit more determined, the IT giant could have hunkered down and waited out the storm in pursuit of its long-term strategy. They certainly had the resources, including cash, to do so. Instead, despite the fact that analysts backed the tie-up, Microsoft's quick departure looked distinctly like a childish sulk. This happened, according to the Financial Times, just days after Yahoo founders Jerry Yang and David Filo supposedly flew to Seattle for a last-ditch negotiating session with Ballmer and Kevin Johnson, who oversaw the computer giant's internet operations.

The situation was complicated by a poison pill provision in Yahoo's corporate regulations. In May 2001, the company had adopted a "stockholder rights planwhich stipulated that unless a deal was recommended by the board, shareholders would have the right to buy extra shares so that it could effectively block a hostile bid.

In order to be successful with a hostile bid, Microsoft would have to first persuade shareholders to get rid of Yahoo's board and replace it with pro-takeover executives who would either rescind the poison pill or recommend the bid. Microsoft referred to this provision in its walk-away statement of May 5th 2008 when Ballmer said to investors in a letter that he had decided against this approach because it "would necessarily involve a protracted proxy contest" either for the shareholder vote or for changing the board.

However, Ballmer and his advisory team would have (or, as we've seen in the section on due diligence, should have) been well aware of this provision when they approached Microsoft in the first place. Which begs the question: Why make a friendly bid unless you know it will be well received? And why make an unfriendly approach if you aren't prepared either to go hostile or to play the long-game and get investors onside? Regardless of history's judgment on Yahoo, at the time Ballmer looked like a weak executive who had taken just one punch and then run away from a fight.

For Microsoft, that was the end of Yahoo merger saga but it left the target in a very difficult position. Several pension fund shareholders launched lawsuits against Yahoo's management. Carl Icahn, who continued to buy up shares, eventually helped to force out the CEO. Yahoo ultimately signed up to a much less remunerative partnership deal on internet search and advertising with Microsoft over a year later in July 2009, leaving shareholders out of pocket and the company the proverbial tech industry "might-have-been".

Opening Gambits

Your place or mine?

First meetings between board-level executives of a bidder and target are often key to the success or failure of deal, whether they are used to initiate takeover talks or to draw them to a conclusion.

Unfortunately for romantics, organised meetings between executives often take place in very dull buildings. The days of high-powered chief executive-level breakfasts or lunches in classic spots such as the River Room at the Savoy Hotel in London or the Rainbow Room at the top of New York's Rockefeller Center are, unfortunately, largely gone. Lawyers' offices are a particular favourite now: the uninviting grey exteriors of London's so-called Magic Circle of top law firms – or their equivalent in Frankfurt, Tokyo, New York and Shanghai - have provided cover for executives to meet and discuss the biggest deals of the last decade.

Quite why a tradition arose that legal advisors are considered to have more neutral venues than investment banking advisors - or accountancy firms - is unclear. Downtown meeting rooms in hotels are also commonly used, as the anonymity of hotels is a definite plus as it may be less likely for a curious journalist to note that two senior executives have met together in a private conference room there. Another equally used - and equally mundane - location for these jet-setting chief executive level meetings are private corporate rooms at international airports such as New York's JFK or London's Heathrow, as often the CEOs are not based in the same city so someone needs to fly to the face-to-face meeting.

When it comes to floating the possibility of a merger with a rival - or discussing relations with a key investor - trade conferences can offer a more imaginative and informal opportunity. Indeed the serendipity of meeting an executive at such a conference can sometimes lead to a discussion where the idea of an acquisition or merger is hatched, for later follow-up in the lawyer's or accountant's offices a few days or weeks after the conference. These trade forums may be even more important to buyers and sellers of small companies who may not be invited to the truly global conferences such as Davos.

Trade Relations

Every January, The World Economic Forum in Davos, Switzerland is the king of international business conferences. Attended by politicians, bankers, financiers and the chief executives and chairmen of global corporations, this jamboree collects a higher density of billionaires and decision-makers than anywhere on the planet.

Although a limited number of accredited press are invited to the conference, most attendees behave as if nobody is watching them. The public rooms provide a great opportunity for people spotting; in 2010 for instance, any attendee could observe Irene Rosenfeld, then head of Kraft, deep in conversation with activist investor Chris Hohn. Having just completed the acquisition of Cadbury at a higher price than her key shareholder Warren Buffett would have liked, observers were left wondering whether she might be expecting the rebel shareholder to register his concerns.

Further away from prying eyes at champagne-fuelled private parties sponsored by the likes of Google, Standard Chartered and McKinsey, a chief executive could float a merger in relative peace. The mountains behind the conference centre and those in nearby ski resort Klosters contain dozens of upmarket chalets where truly private business functions can be held; the failed merger between News Corporation and UK-listed BSkyB was indeed mooted in one.

Davos might be the king of conferences and is actually as much a collection of politicians and country finance heads as of business men and women. But there are other, more focused, industry events where deals can be casually raised. The annual tech industry conference run by Allen & Co in Sun Valley has generated some important technology sector developments.

That conference, which has been going since 1983, offers whitewater rafting, tennis, hiking and yoga sessions. But, as at Davos, much of the work is done in private rooms or at the bar. Some examples:

- In 2008, key players in the Microsoft-Yahoo merger including Yahoo's President Sue Decker, Google founder Sergey Brin, Yahoo's former chief Terry Semel and some of Yahoo's major shareholders were gathered for a chat in Sun Valley.
- The Idaho conference gained a reputation as a deal-making centre in 1996 when Disney's former chief executive Michael Eisner hatched a plan to buy the ABC television network.
- In 2014, it gave birth to the merger between AOL and Verizon. Although the deal was not announced until 2015, executives from both companies met up a year earlier at the conference to explore possible commercial opportunities.

Fast or Slow?

Some executives, including those in the Microsoft-Yahoo merger, do not make it into a room together until a deal is about to collapse. In this case - where there was interest on both sides in doing a merger - this was a terrible mistake and contributed to Microsoft walking away.

In other cases, it is a deliberate and successful strategy to keep the chief executives apart until right at the end. Kraft made some bad mistakes in its 2010 takeover of Cadbury, but the US company's decision to keep Cadbury's chief executive Todd Stitzer and chairman Roger Carr at arm's length until right at the very end of the deal was probably not one of them.

Kraft Chairman and CEO Irene Rosenfeld knew that she did not want to keep Cadbury's board nor, particularly, the company's senior executives; she wanted the company's brands and its emerging markets business. On the other hand, she had challenges with her own share price as the offer was part-cash, part-shares and there were other issues simmering with the financing and investors. There was little need to speak to the target's board until she was in a position to make a proper offer.

The Baxalta Bear Hug

On the other hand early and focused engagement with the target's board and investors can be helpful in a "Bear Hug", as we can see from pharmaceutical company Shire's acquisition of Illinois-based Baxalta.

Companies who do their homework properly can complete the formalities behind a takeover very quickly. Speed and surprise can also be advantageous tactics when mounting unsolicited takeover bids. One example is Shire's pursuit of smaller US-listed pharmaceutical industry rival Baxalta in the second half of 2015. Anglo-Irish Shire surprised the markets by going public with an all-share $30 billion takeover offer for Baxalta in July 2015 at a premium of more than 35 per cent to Baxalta's undisturbed share price.

The pursuit came less than a year after Shire was left at the altar by its larger rival, US-based AbbVie, following political opposition in Washington that derailed the agreed deal. One of the major attractions of Shire for US buyers was the potential to access tax savings thanks to the company's tax-domicile in Ireland where corporate tax rates are much lower than in the US. Once the AbbVie deal collapsed, Shire was free to pursue its chosen partner from the pool of pharmaceutical companies operating under the comparatively high US tax regime; as such, Shire had a lot to offer as a merger partner and acted quickly to take advantage of that.

Shire's pitch to Baxalta was that they could together create a world leader in the medical treatment of rare diseases, an increasingly lucrative field. The Anglo-Irish bidder not surprisingly - and with the backing of some analysts - argued that the acquisition would be to the benefit of both sets of shareholders, not least because of Shire's more advantageous tax regime.

Baxalta had been formally spun off by its parent company Baxter Industries for just one month when Shire announced its approach; the Anglo-Irish business reportedly informally approached its target just nine days after Baxalata gained its separate corporate identity. Given the timing, it is very likely Shire - as with other good acquirers - had been monitoring its target for some time.

The offer was batted off by Baxalta's chief executive Ludwig Hantson who called it "puzzling." Shire's next move was to put Baxalta in a 'Bear Hug. Like Yahoo, Baxalta's corporate charter included a poison pill clause designed to fend off hostile takeovers. This clause stipulated that should a bidder begin trying to buy its shares on the open market, Baxalta could issue additional shares to incumbent investors once that bidder reached a stake of 10 percent.

The only way to get around the poison pill was to secure a board recommendation or to remove the board, which in Baxalta's case was made more difficult by a subsidiary defensive tools that meant board terms were staggered, so it would take longer to eject a majority of the board members as only a certain number could be replaced at any one time. Recognising these defences that Baxalta had in place, Shire focussed its efforts on persuading shareholders to push for a board recommendation - something Microsoft could have done more effectively than it did in its bid for Yahoo. Because Shire needed that recommendation, it also structured the deal financially to appeal Baxalta's sitting board, entitling them to multi-million dollar pay-offs.

Shire's chief executive and chairman spent the next few months personally criss-crossing the Atlantic to press their case for the proposed deal with Baxalta's US-based investors.

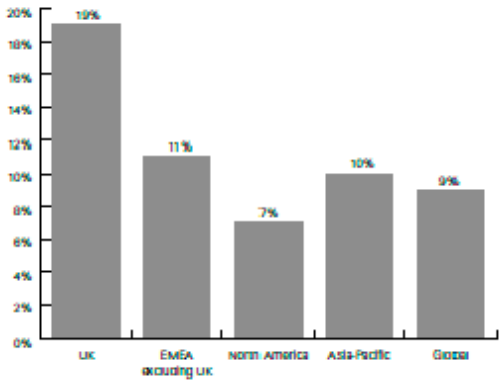
Shire's bold approach ultimately paid off when Baxalta's board accepted a sweetened part-share part cash offer valuing the company at $32 billion. Investors had made clear they wanted a cash element in return for their support as Shire changed its bid to 40 per cent cash, 60 per cent shares. By this point, Baxalta's investors were pressing strongly for a recommendation and the target's board responded by agreeing to one.

Announcing the deal in 2016, Flemming Ornskov, Shire's Chief Executive, said revenue synergies from the merger could push combined revenues to $20 billion by 2020, compared with $12 billion in 2014. It is too early to assess Ornskov's promises, or whether Baxalta was the right target for Shire's shareholders. But what Shire and its board did do was carefully select its preferred target then make its move swiftly and with tenacity. In terms of negotiating tactics, we can already say this one was a blockbuster.

Still Leaking?

When we discussed leaks in an earlier section, we said that they can be used by sellers as a negotiating tactic to increase leverage over buyers, for instance by bringing counter-bidders out of the woodwork. The myth of the accidental leak – the deal folder inadvertently left by an analyst in the back of the taxi - is just that, a myth. Most leaks look deliberate. And there are many, as the figures shown from the study demonstrate.

Figure 0.6-B: Percentage of deals which leak across regions



Of the M&A advisors surveyed for that Intralinks study about leaks, half thought that leaks could be good for deals, although nine out of ten conceded they can backfire. And it must be mentioned that regulators truly frown on firms and deals where there have been leaks, as they bring into question the integrity of the markets. Leaks done wrongly can get an advisor or a firm in trouble with those regulators.

Leaking is not restricted to the due diligence phase - it has much wider applications and deliberate 'leaks' are used during negotiations. Not only is there evidence that sellers use it to bring in rival bidders, but buyers use it to scupper a deal they are cooling on.

Although leaks are a tactic in the arsenal of unfriendly bidders, they are most damaging in a friendly context. Friendly deals are often announced with great fanfare, with deal completion plans, post deal senior management teams and even integration plans ready to be announced well advanced.

However, if a deal has to be prematurely announced because of a leak, these plans may not yet be fully developed and the pre-approvals of key stakeholders and regulators may not have been completed, nor the planning for the integration of the two companies post-closing. As we will see in the next section with Prudential's failed $30 billion bid for AIA, an early leak can mean the difference between success and failure.

Negotiating Tactics: THE DOs AND DON'Ts

- **Do be aware that the first approach is usually the key one**
- **Don't launch an approach until you are fairly sure how the target will react**
- **Do your homework on any poison pill and other defences the target may have**
- **Don't expect to be able to delegate the negotiations: the CEO and Chairman WILL need to be involved in big deals**
- **Don't be afraid to use a deliberate 'leak' to move things along…but do be aware that such a tactic can backfire**

0.7. The Engagement

Of our Three Big Mistakes, this section concentrates wholly on the second.

Communication is not just about the time when a deal is announced or - if you are unlucky - the moment it leaks. From the moment when a CEO starts thinking about an acquisition strategy, through the announcement of the deal to post-merger integration, a top drawer communications plan that takes in shareholders, employees and all the critical external stakeholders is not just a “nice to have” add-on. It is crucial for successful deal-making and deal completion.

Whilst listed companies nearly always have internal and external PR (public relations) advisors, for smaller or private businesses, good communications need not necessarily involve hiring an expensive public relations agency; the important thing is that somebody at your company does it.

Most deals get done without the knowledge of a majority of the employees of both firms – with the obvious exception of start-up businesses – as the knowledge that a deal might be on the cards could cause concern amongst employees due to it often involving job losses. Even if this is not the case, deals are often a catalyst of organizational change and the notion of such a change on the horizon is likely to cause unwelcome distraction. The day of the announcement is therefore likely to be the first time when employees of both firms will find out their work environment will change significantly. Most people don’t like change, of course, and surprises even less. So crafting a story about the reason for the deal, why it is a ‘win-win’ situation and what it will mean for employees on both sides is paramount not to cause additional confusion, fear and ultimately lose key people. It is also a chance for the combined management to showcase a joint frontline, especially important for the employees in the target company, who are likely to feel the least excited about having been taken over.

In this section we will consider the reasons why you need a PR strategy and a plan to implement that PR strategy, whether or not you use an outside PR firm. We also look at communications with shareholders - both institutional and activist - that will often be handled by either management or their investment banking advisors. Finally, using the example of Prudential’s 2010 bid for AIA, the Asian arm of AIG, we will show you a communications disaster where poor planning and communications scuppered what could have been a transformational merger for the venerable UK insurer.

Spinning Tales

In the old days, PR advice on an M&A deal was an optional extra. Those days are long gone. In the past two decades, public relations professionals – sometimes called corporate communications or financial communications professionals - have become one of the first numbers on a CEO’s speed-dial list.

Research by the Mergers and Acquisitions Research Centre at Cass Business School shows why there is a sound financial reason for this. In Selling the Story, Cass found it pays to pay for PR. The research, which examined 198 large public-to-public UK M&A deals from 1997 to 2010 found that deals with PR firms on board had a significantly higher chance of completion than those without. When PR firms advised both the bidder or target, over 90 per cent of the deals completed successfully, whereas those without any PR advisors did so just over two-thirds of the time.

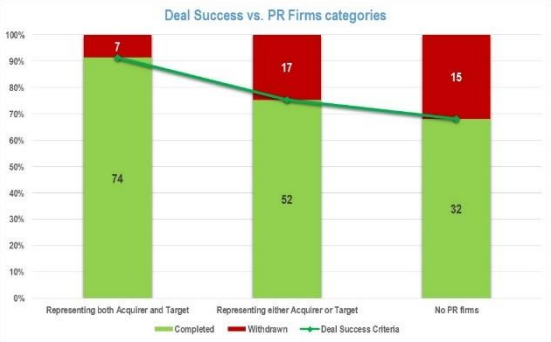
Given that PR advisory costs tend to be a tiny proportion of total deal-related expenses, hiring a professional communications team in a larger deal is both sensible and cost effective. For smaller companies, it may even be a necessity as they don’t have other deals to fall back on.

These PR advisors can, in the words of Anthony Cardew of PR firm Cardew Group, whose clients include Smiths, Thorntons and Lonmin, ‘play a very important role, especially in long-running M&A sagas, as long as they are sufficiently well connected to management to do their job properly; if a

PR agency doesn't have the proper links with the management team it can't work in the same way. It's certainly not just about talking to journalists on the day of a deal. You need to be spending time helping the company to communicate its long-term strategy to a range of stakeholders - whether you call that public relations or something else.'

Another leading London-based PR expert, Chris Salt, Partner, Headland Consultancy which advises clients including Danone, the AA, Legal & General and Johnson Matthey, added that 'many PR advisers will be in place long before a deal is on the horizon. Therefore, one of the key tasks would have been to work with the company to tell the corporate story in such a way that any bid or M&A activity makes sense in the wider context of a long-term strategy. And secondly, where some advisers might be just there for the deal, how one communicates during the deal process may have a strong bearing in the post-deal world for a company.'

Figure 0.7-A: PR effect on deal success



The timing of public company deal announcements was also important. Deals announced before the start of trading were far more likely to be completed than those announced after the market opened. Deals announced between 7:15am and 9:00am had the highest completion rate at 87 per cent; this fell to 64 per cent after 9:00am. Again, this points to good planning and a tight deal team with an ordered confidentiality process. Why? Because an announcement after the market is open is more likely to be one that is made in response to a leak or rumour, and therefore not one that was scheduled or planned in advance.

The content of the initial press release is critical, as it will set the tone for any subsequent media coverage. As in all things in life, first impressions are important, even to the hopefully dispassionate shareholders who will ultimately decide whether to approve the deal.

Even after the first public statements about the deal, the merging companies need to keep control – to the best they can – of the external and internal communications. Sir Roger Carr, the chairman of Cadbury during its takeover by Kraft, described a meeting that took place each Friday to determine the PR strategy for the weekend in order to control the news reported in the Sunday press. The tone of those stories, he said, often determined how the press would react during the entire follow week. This is especially important as there may be leaks.

Cardew spoke about this in saying that 'often reports of deals after leaks are only partially accurate so if you are trying to justify an investment case it is really hard to row the story back to your territory because of the aggregate nature of the news media. There is a perceived wisdom it takes weeks to overturn.' He went on to say that 'once a leak happens, you have to deal with the reality of it.'

Salt added that 'leaks can be bloody annoying when you are on the receiving end. They often distort the position you and your client wants to take and that can mean you lose time regaining the agenda. Having said that, there isn't a deal that exists where a strategy to counter a leak hasn't been considered and planned for. As to fatality? Rarely.'

Of course, most companies won't be front page news as was the above Kraft / Cadbury deal and most deals therefore aren't subject to leaks. For those, control of the internal news grapevine is most critical. This internal communications strategy should be planned from the very early stages in the deal. As Cardew said, 'A deal that is understood is going to be well received. What you've got to do is to tell a compelling story.'

One element that appears in almost every deal announcement is the discussion of potential synergies. This is not only because it can fully or partially justify the premium that the buyer is paying, but it also signals to the market what the buyer intends to do with the target. In PR advisor Salt's words, 'Whatever may be your side's contention regarding anything involving a deal – not least synergies – you must be clear. Crystal clear. Or you risk losing your investment argument.'

These synergy questions will include:

- Will the target be fully integrated, leading to larger synergies? Or will it be kept principally as a separate division by the new owner?
- What will be the timeline for achieving those synergies, and thus will the changes to the two companies – but especially the target – be implemented quickly?
- How will the business model change?
- What will be the cost to achieve those synergies, and when?

Synergies are often an area where management, at least with the public figures provided, choose to 'under promise and over deliver'. However, when there is resistance to the deal after announcement, it might be necessary to revise the synergy targets upwards and spending forecasts downwards.

Institutional Investors: A CEO's Best Allies?

For publicly-listed companies, institutional investors can make or break an M&A deal. Communications with institutional shareholders - and where there is a large retail shareholder base, with retail shareholders - should begin in the strategic phase if at all possible.. Any major move such as an acquisition or disposal should be signalled to investors well in advance and be part of both a coherent corporate strategy and a wider communications plan that also takes in the media and other stakeholders, particularly employees.

Early signalling - which is only possible when a company has its own strategy in good order - is crucial to the success of an M&A deal. Prudential's 2010 failed bid for AIA, the Asian arm of US insurance giant AIA demonstrates what happens when a CEO suddenly and without warning takes his company in a very different strategic direction.

Further research, entitled *Learning from your Investors: Shareholder support in M&A transactions* from 2011 by Cass Business School's Research Centre, suggests that corporates can actually learn and benefit from expert investors. The study looks specifically at investors in a listed company who are likely to be either institutional investors (such as pension funds or insurance companies) who have particular geographical expertise or sovereign wealth funds with good local access. These can all be harnessed by savvy management teams during the M&A deal process. The principle also applies to privately-held companies where, for instance, private equity firms who own a stake in their portfolio companies will also put one of their partners on the board of those companies, not just to keep an eye on the business, but also to offer fresh expertise and advice.

Companies who had such 'monitoring' investors (those who manage their stakes actively) with superior regional expertise could expect to have more long-term success in cross-border M&A deals within that region.

Looking at a sample of investment into the UK, the study found that acquirers whose deals were supported by institutional investors with local knowledge in the target region clearly out-performed those who were not. Those acquirers with such support outperformed the market by 55.7 percentage points compared to those without it, who beat the index by only 6.3 percentage points.

One of the key aspects of the research is when the polar opposites of cross-border M&A strategies are compared:

- "Blizkrieg" where there is a rapid entry into a new foreign market through acquisitions, largely planned and conducted secretly, versus
- "Playing the Long Game" where the company gradually works over time to build a dialogue between management and key expert institutional investors in target foreign markets before entering.

The latter strategy may result in superior corporate performance and underscores the point that information should not just flow from management to the market but that information needs to flow in the opposite direction as well. The company needs a clear plan to get information from the market – here, for cross border deals according to that study, to necessarily include those knowledge-intensive institutional investors.

Communication between management and public market participants such as institutional investors must be managed carefully as those conversations may contain market sensitive information. Exchange of sensitive and specific target information between the two sides could lead to the imposition of restrictions in many countries on an investor's ability to trade shares, as it exposes them to inside information not available to other investors.

This is an area where regulators keep a close eye on any market manipulation or insider trading. The solution to this dilemma is to get in early. If institutional investors are fully briefed in the months and years leading up to takeover bid about the company's overall strategy and general M&A plans (but not any specific deals or specific target companies), they will not need to have conversations later about market-sensitive information that would cause them to be "brought inside" with a consequent trading ban.

Rise of the Activists

As well as introducing the general public to the inside workings of a hostile takeover, the 1987 film Wall Street immortalised activist investing in the person of its anti-hero, Gordon Gekko. In the days when 'greed was good' and 'lunch was for wimps', Gekko and his ilk went by a less sanitised name: corporate raiders. The stereotype said these men (and yes, in those days there weren't any female corporate raiders) were the jackals of capitalism, hunting down and dismembering weak companies for profit without a care for the thousands of job losses that then ensued. Consequently in the 1980s, such men were also known as asset strippers.

But in the intervening years, the practice of activist investing has morphed into something perfectly respectable, a mainstay first of Wall Street and now in other financial capitals. Some of the original corporate raiders - most notably Nelson Peltz, through his hedge fund Trian, and Carl Icahn, now a very active octogenarian - are still around. These days they are part of the establishment but nevertheless still feared by corporate boards.

In the first decade of the new millennium they were joined by a host of arrivistes determined to shake up the companies in which they invest and who use a range of tactics from the fairly hostile to the relatively friendly – all designed to persuade management to do what they feel is best.

According to research 2015 from the investment bank JP Morgan entitled 'The Activist revolution',, funds under management by activist funds had ballooned from $12 billion in 2003 to $112 billion in 2015, with most of that increase taking place after 2009. In addition, multi-strategy funds (funds that use a number of investment methods in parallel) have refocused significant amounts on activist strategies. Their report stated: "Adding to the dynamism of this asset class, new funds are entering the shareholder activism arena at a rapid pace (typically lieutenants of established or non-activist fund managers pursuing activism as a new strategy) and traditional institutional investors increasingly support - directly or indirectly - shareholder activist campaigns".

Activists can tackle a range of issues from under-performance to poor governance, but often they seek to persuade management to drop a takeover that they feel undervalues the company, be acquired when the value of the company exceeds its current market capitalisation or sell off non-core assets that the market undervalues. In some instances they may attempt to engage a board in private dialogue, while in others they will go public with their case in the hope of mobilising a company's broader investment base. Or they start with the former but hold out the threat of the latter if the private dialogue doesn't lead where they want to go.

Activist investor Elliott Management, for example, applauded computer company Dell's 2015 acquisition of EMC, because they expected Dell then to sell off a number of divisions. Prior to the deal, Elliott had been pressuring EMC. Thus one company's acquisition became the foundation for potential future M&A deals through divestments.

In the past, companies have batted activist investors away or attempted to ignore them, but today it is widely accepted that the best option is to engage with them as part of a broader cohesive public relations strategy that includes investors, stakeholders and the media. Corporate advisors, principally investment banking and public relations advisors, have a key role to play here.

"Today's activist campaigns are sophisticated public relations contests, fighting for the support of the company's shareholder base. Companies must approach their preparation and responses while keeping this new reality in mind," says the JP Morgan report.

And whilst it was previously common to ignore activist shareholders who had a stake of less than five per cent, smart boards have also recognised that a strong activist's ability to galvanise the broader shareholder base means that they ignore such investors at their peril.

Indeed, companies are changing their corporate by-laws to allow these minority investors to exercise more control. In December 2015, Apple changed its by-laws to allow a group of up to 20 shareholders to nominate up to 20 per cent of Apple's board. They joined other large American companies such as Microsoft, Coca-Cola and Philip Morris International to have introduced similar changes in the same year.

Whilst activism was born in the US, activists are increasingly influential in Europe and Asia. JP Morgan reported that, in mid-2014, that forty per cent of activist hedge funds globally have either a European or a global investment focus. Despite the seedy reputation of their early days, shareholder activists have so far managed not to draw the eyes of regulators, but this may be about to change.

Mary Jo White, the chairwoman of the US Securities and Exchange Commission, said that activists must be very careful what they say when calling for corporate change. "I do think it's time to step away from gamesmanship and inflammatory rhetoric that can harm companies and shareholders alike," she said, as reported by Fortune in early 2014. Her comments came in the wake of stake-building by US hedge fund activist Bill Ackman in Valeant, the drug company, with whom he was making a joint bid for its rival Allergen.

Because Ackman knew about the bid ahead of time, a US judge examining the case said there were serious questions as to whether his fund had broken insider trading rules. The very nature of what

activists do in taking stakes in businesses and engaging management on strategy may make them vulnerable to market manipulation investigations.

Yet at the moment they are riding high. Over the years, Microsoft, Cadbury, Pepsi, Mondelez (formerly part of Kraft Foods), Time Warner, GDF Suez, Britvic, Lloyds Banking Group, Amec, Barclays Bank and even stock exchanges themselves such as The Deutsche Börse and the London Stock Exchange, have all seen their takeovers - actual or planned - influenced by activist shareholders. No corporate is too big for them to target. They are here to stay.

Prudential's Imprudence

In Europe the insurance sector emerged from the financial crisis in much better shape than the banks, having escaped its own liquidity crisis more than a decade previously. In February 2010, one of the most powerful and ambitious insurers was London-listed Prudential, a global insurance giant with booming emerging markets interests.

Led by the charismatic Tidjane Thiam, the Pru was plotting a bold $35.5 billion (£24billion) move to buy AIA, the Asian arm of cash-strapped US insurance company AIG, a business considered by many to be the jewel in its crown. The problem was that not only were the markets against Thiam; governments, regulators and investors alike were still reeling from the impact of the UK bank bailouts and the eurozone looked to be on the brink of collapse. He and his team also made a slew of mistakes in communicating the benefits of the deal to shareholders.

Robbin Geffen, a fund manager at London-based Neptune who corralled the "No" campaign against AIA later described the deal thus: "From the beginning it has been an absurdly ambitious attempt by the Pru to buy a very large Asian company, at a very high price, with a very unclear strategy."

Pru's first communication mistake was that for its shareholders, the deal came out of the blue; as Cardew put it, 'anything that surprises people is not good; the stock market does not like surprises.' Other shareholers must have agreed from the start, as Pru's share price dropped 8 per cent within days of the announcement over concerns that also include worries about the size of the money that Pru would need to raise to pay for the deal.

Given that the acquisition would have doubled the Pru's market capitalisation and dramatically shifted its centre of gravity from its home markets in Europe to fast-growing Asia, management should have known the deal was always going to be controversial. Although much of the money raised by the £14.5 billion rights issue was expected to come from Asian sovereign wealth funds and the deal itself was in Asia, management appeared to forget that it still needed the votes of its longstanding UK institutional investor base in order to get it through.

According to The Telegraph, "As one expert observer said: Tidjane wanted to fire his current investors and get some new ones. He just forgot about the vote."

In this case the deal leaked before the Pru was ready to announce, which goes some way to explaining the ensuing panic by the insurer's board and advisors. But it is anyway generally safer to warm up shareholders over a period of years, not months, weeks or days, when planning such a major initiative.

Thiam's troubles did not end here. He then faced a media storm about his appointment to a seemingly innocuous non-executive directorship at Société Générale, a French bank with its own significant challenges. The appointment was portrayed in the media as a diversion and, under pressure, Thiam turned it down.

But perhaps most seriously of all, as it was legally bound to do, the Pru had failed to inform the UK's financial regulator, the Financial Services Authority [FSA] that it was planning to buy AIA. This meant that not only did the insurer have to delay its rights issue prospectus, but, in the regulator's eyes, the

acquisition of AIA would leave it under-capitalised. Since this was a time when banks across Europe had recently collapsed and many were still considered as requiring possible government bail-outs, the FSA's ruling was extremely damaging. Although AIG was later able to negotiate a solution, the public relations damage was already done.

Furthermore, the insurer was fined £30 million - one of the FSA's biggest ever fines at that time - in 2010 for failing to keep the FSA in the loop. Thiam was personally rebuked for his part in that failure. "The failure to inform the FSA was significant because it resulted in the FSA having to consider highly complex issues within a compressed timescale before making a decision as to whether to suspend Prudential's shares," said the regulator. "It narrowed the FSA's options in scrutinising the transaction, risked delaying the publication of Prudential's subsequent rights issue prospectus and hampered the FSA's ability to assist overseas regulators with their enquiries in relation to the transaction."

Thiam did manage to bring his core investors back onside. Three of the biggest - Legal & General, Janus Capital Management and Capital Group - backed his bid following a personal charm offensive by the chief executive and his chairman. However, the Pru was now presented with another problem: it had agreed on a final price with AIA, but in the wake of that agreement, financial markets around the world had tumbled further, particularly in the Euro area.

The Pru tried to renegotiate on price, but ultimately AIG - which by now was understandably concerned about the Pru's ability to get a deal done at all - turned the new offer down. Because the Pru's reputation had taken such a battering, it did not even try to revive its own deal. AIA was subsequently floated and its share price more than doubled in its first five years of being publicly owned.

So would Prudential's shareholders have been better off backing the deal? Thiam certainly thinks so. In 2014 he told investors that the company had missed a "once in a lifetime opportunity." He added, "I'm still animated about it. I apologise for not succeeding".

The Pru deal is a great example of the "Blitzkreig" method we compare with the safer and more gradual 'Playing the Long Game' M&A strategy. While there is a strong argument that the AIA acquisition would have delivered great returns, it is not clear that this was exposure that shareholders in the Prudential, a conservative company founded in 1848, actually wanted. And for those that did, they could anyway buy AIA shares when the company was floated anyway.

What do the PR advisors suggest as best practice in this area? Cardew said that 'it's certainly not just about talking to journalists on the day of a deal. You need to be spending time helping the company to communicate its long-term strategy to a range of stakeholders - whether you call that public relations or something else.' He went on to suggest that 'a deal that is understood is going to be well received. What you've got to do is to tell a compelling story. It is absolutely crucial to lay down the context in which you might be announcing anything - what is your overarching narrative - a long time ahead.'

In short, there are a number of ptifalls for dealmakers, but we would argue that "selling the story" is one of the most important. Here we mean that buyers and seller management need to address the question "What is our deal Story?" early and devising a communication strategy as soon as possible in the deal process. For all kinds of stakeholders both internal and external, we also argue that this is equally important for large or small, public or private deals. Poor communication could scupper a public deal, as with Prudential case, but poor communication could have even more devastating effects for private transaction: the deal may go through, but because of poor communication the buyer loses most of the value as it fails to keep key people in the target and even in its own organization.

The Engagement: THE DOs AND DON'Ts

- **Do treat your shareholders with respect – they have the power to derail the deal**
- **Don't spring surprises on shareholders; they should be fully aware of your strategic objectives**
- **Do make sure you have a communications team in place, whether internal or external**
- **DO communicate, communicate, and then when you finish communicating, communicate some more**
- **Don't forget that the internal employees are just as important a target group for the communications strategy as the external press and shareholders**
- **Do engage with activist investors, it will be easier in the long run**
- **Do make sure all the details are in place before the announcement is made**

0.8. Beware of the Regulator

A growing issue for every ambitious company, particularly those targeting cross-border acquisitions, is the proliferation of regulators and governments who can and are willing to block the most coveted takeovers.

As the markets become ever more active globally, so too do the number of merger control regimes across the world which are growing as countries bolster their national competition policies. This is not just true in the world's two major trading blocs, North America and the European Union, but the Chinese government is also now much more active in their use of rules against anti-competitive activity.

There are also a growing number of specialist national regulators that make merger controls in particular key industries such as the OfCom, the media regulator in the UK, or the Food and Drug Administration, for the pharmaceutical and health care industries in the US.

In the US, merger control is policed by the Federal Trade Commission and the anti-trust division of the Department of Justice and ultimately the Supreme Court. In Europe, the European Commissioner for Competition, a member of the European Commission (the EU's top political body) has responsibility for merger control. Possibly since its decision to block the trans-Atlantic merger between General Electric and Honeywell put the European Commission on the global map in 2001, it is many of Europe's decisions that have been the most controversial.

The trend has continued in recent years. The regulator's move in early 2012 to stop a tie-up between two huge stock exchanges, NYSE Euronext and Deutsche Börse, even after the US had provided conditional approval just over one month earlier, shows how crucial EU approval remains. Early assumptions that decisions were based on political contacts are now well wide of the mark as the EU regulator continues to build its case law. Here, as we see in the other two case studies in this section, failings of communication and planning are most likely to create difficulties for bidders facing major regulatory inquiries.

Small private companies can fall foul of regulators just as easily as listed companies. The broad test is whether the newly combined businesses dominate their sector even within a relatively narrow geographic area.

The second key issue for all bidders, but particularly those based in another country from their targer, is whether there are local rules specifically relating to 'proper behaviour' during a takeover: the corporate law of takeovers, whether explicit legislative laws or legal case history. For example, under the UK's Takeover Code, which covers all transactions relating to publicly listed companies in the UK, all bidders for UK listed companies are bound by the code be they foreign or domestic. Global retail and property magnate Sir Philip Green famously fell foul of the code when he was held by the Takeover Panel to his promise that his doomed bid for Marks & Spencer was his final offer, since he stated publicly in July 2005, that "this is my final proposal." He added that if Marks & Spencer rejects it, "I'll go home." Once said, such a statement prohibited him for a time from changing his proposal without the permission of the target.

However, such rules are particularly easy to overlook for overseas bidders used to dealing with a different legal system. In this regard we consider whether Kraft in its 2010 bid for Cadbury overpaid because it did not take sufficient care to abide by these rules.

The third sort of regulator we consider is each country's national government. Governments around the world take their own approach to foreign investors. Most dramatic is the recent upswing in regulatory or legislative reviews through political intervention against foreign investments, with national governments considering the impact of takeovers on local jobs, economies and national security. In

fact, elected officials often use public statements to oppose or support M&A deals even without the formal powers to do so, again as we will see in the Kraft acquisition of Cadbury.

The 'Danone Law'

Government interventions in cross-border M&A deals can be hidden behind an aura of anti-trust control or national security as governments around the world from France in Europe to the US in North American and China in Asia have done.

One example of a company protected by its government in obviously nationalist circumstances is Danone, the French dairy food group. Due to its narrow focus and small size, Danone has long been viewed as an attractive target for food groups such as Nestlé and PepsiCo.

After the company's share price spiked in 2005 on a rumoured bid by PepsiCo, the French government stepped in with a law protecting certain industries from takeovers. The law was dubbed the "Danone Law" and was designed to protect "strategic sectors", including those likely to impact on public order, national security and defence. It has often been joked that the company is strategically important for France because the army relies on Danone yoghurt at breakfast.

The US government is not often viewed as one of the worst culprits for protectionism, yet our case study later in this section shows that a government can step in even when there are no real "national security" issues. As with our case study on Deutsche Börse, this emphasises yet again the huge importance of good communication if you plan to launch a controversial bid.

Kraft's takeover of Cadbury hits a sour note

The £10.1 billion takeover of Cadbury, the UK-listed global confectionary business, by Kraft, was a deal that had been years in the making. With key shareholders in common, particularly activist Nelson Pelz, a combination of the two companies seemed inevitable, even if it was unwelcome to the board of Cadbury, who hoped until the end to be saved by a white knight bidder such as the American chocolate manufacturer, Hershey or the Italian chocolatier, Ferraro.

Having coveted Cadbury for years, Kraft was determined to get its target and looked likely to do so from the outset of its bid. There were no significant competition issues; the businesses were complimentary, not competing, both in terms of product and geographies. Thus regulators were never in danger of de-railing the deal completely. Yet Kraft certainly made mistakes that others can learn from, errors that fall absolutely within our Big Three.

Other than gaining the approval of Cadbury shareholders in light of the opposition of the Cadbury board, the most high profile hurdle for Kraft was the vocal opposition raised to the deal by UK politicians. The Business Secretary, Lord Peter Mandelson, warned that the British government would scrutinise any foreign takeover of Cadbury and would oppose buyers who did not "respect" the confectioner. In reality, the British government's actions were heavy on the bark and light on the bite. The UK is one of the most open countries in the world to foreign investors and is consistently one of the most attractive because of this, according to Cass Business School's annual M&A Market Attractiveness Survey. Its appeal is strengthened by its legal regime as the UK cannot challenge foreign takeovers other than on grounds of national security.

Unlike our example of the French government and Danone yoghurts, this definition is never really stretched and in this case the UK government made no regulatory challenge to the takeover. Here Kraft got it right; the company knew at the outset that its deal could not be blocked.

However, the deal fall prey to errors in planning and communication, as they ultimately needed the approval of shareholders, including some large UK institutional investors. To gain this approval, during the takeover Kraft promised keep open a factory in Southern England. The company made the promise in a bid to win over public opinion, but it did so without any real evidence of the factory's

viability. Because it was a hostile bid, the bidder had no access to proprietary target company information and certainly not the internal confidential plans to close a plant that would result a large number of employee redundancies.

Once Kraft took over Cadbury, it found the plant was not critical to the business and indeed discovered that Cadbury itself had been planning to shut it down. Kraft therefore subsequently announced that they would close it, leading to a massive public outcry. There were two consequences to this failure of planning and communication: the first was that the company was twice summoned before an influential Parliamentary committee to give an account of itself.

More critically, during the bid battle, Kraft breached the UK's Takeover Code. As Cadbury was in an offer period when Kraft's statements on factory closure were made, all company statements were being monitored closely by the UK's Takeover Panel. Under the code, companies in a formal bid situation are bound by any public statements about the takeover and must be especially careful not to say anything that is deemed to be untrue or misleading. The Panel subsequently censured both Kraft and its investment banking advisor Lazard for the mis-statements.

Such action by the Panel is rare and thus was a significant embarrassment for both Kraft and Lazard. The fallout was most keenly experienced by Peter Kiernan, the Lazard banker leading the deal in the UK. Kiernan had just recently taken up the role as the next Director General of The Takeover Panel but had to recuse himself after the ruling. With better planning and communication by Kraft and its advisors, this could have been avoided.

Kraft also fell foul of another important element of the Takeover Code that restricts a bidder's ability to change its offer. It made its initial bid partly in shares and partly in cash. Later, CEO Rosenfeld announced the company's intent to increase the cash component of its offer because some shareholders, and most notably Warren Buffett, had complained that she was using too many of the company's undervalued shares to fund the deal. Due to the provisions of Kraft's own corporate constitution, by reversing the mixture from 60 per cent shares / 40 per cent cash to 40/60 respectively, Rosenfeld was able to avoid putting the deal to a shareholder vote, thereby cutting out the disgruntled Buffett.

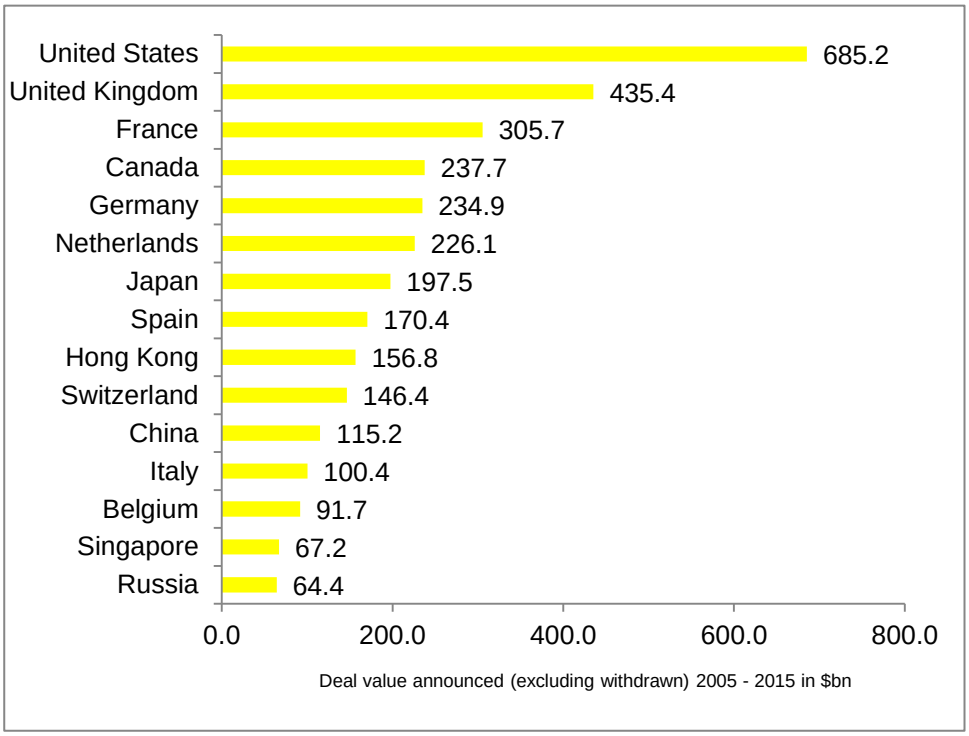
Rosenfeld may have had a good reason for doing this, but under the UK Takeover Code, once you are within a formal offer period, you cannot easily change the terms. To comply with UK rules, Kraft was not allowed to withdraw or amend its initial offer without the approval of the Panel and the target, which in a hostile bid situation was unlikely to be forthcoming from Cadbury. Effectively Kraft would have to keep its old offer on the table in addition to any new offer, meaning it would be obliged to go ahead with the shareholder vote it was trying to avoid in the first place. This gave Cadbury a major tactical advantage.

As it happened, shareholder opinion was moving and investors wanted the higher cash component. Once Kraft signalled it would raise its bid to 830p per share from its original indicative offer of 745p, Cadbury's board agreed to open talks that ended with them recommending an offer for 840p per share, plus a ten pence per share special dividend. Once they provided that recommendation, Kraft would expect that the Cadbury board would then support Kraft's application to the Panel to be allowed to vary its initial formal offer.

Kraft's initial failure, one of planning, is particularly instructive because this restriction on variation is a quirk of the UK regime; no such provision exists in the US. It is unclear whether Rosenfeld knew about the restriction when she made her initial offer or whether she did but pushed on regardless. In this instance the mistake probably would not have stopped Kraft capturing its target, but because the company had to make a knock-out offer in order to get a board recommendation, it likely did mean the US company paid more than it initially intended or hoped to pay.

The critical lesson here is that, in cross-border acquisitions, every element of the local laws governing the target must be explored and expert local advisors hired before any irreversible moves are made. This should be done as early as possible during the takeover planning. The importance of doing this can be seen by the high levels of outbound M&A since 2005 especially in some of the larger developed countries.

Figure 0.8-A: Outbound M&A Value per acquirer country, 2005 - 2015



Deutsche Börse: You can't always rely on the Germans

The European Union was born of a Franco-German alliance risen from the ashes of World War II. Thus one perception in Europe is that if any company has the necessary political intelligence to negotiate a tricky European Commission anti-trust inquiry, it must be a Franco-German one. So, when the European Commission ultimately sounded the death-knell of a merger between Deutsche Börse, Germany's principal stock exchange, and NYSE Euronext, a company itself formed from combining one of America's major stock exchanges and a Paris-based stock exchange that encompasses Brussels and London, it came as a surprise.

It was a particular shock that the block came in the stock exchange sector, where borses are viewed as national infrastructure assets and where arguments of national interest are particularly strong. Certainly Duncan Niederauer, the chief executive of NYSE Euronext, and Reto Francioni, his opposite number at Deutsche Börse, who had together lobbied hard and leveraged every personal connection they had to get the deal through, were taken aback by it. This was a friendly deal where both exchanges wanted to merge with each other.

2010 was the year when many of the world's stock exchanges rushed to consolidate. London's LSE and Toronto's TMX planned a merger that was on course for regulatory approval, although both companies later called it off for reasons unrelated to the regulators. ASX of Australia and the Singapore Exchange also tried to tie-up, but they were stymied by Asian regulators. The merger between Deutsche Börse and NYSE Euronext was by far the biggest and boldest of the three deals and would have created a $9 billion trans-Atlantic giant which would have dominated the global exchange market.

With a proposition that dominant, you really have to sell such a deal to the regulators. While the two companies had a well-planned communications campaign, they seem to have used the wrong forms of persuasion. The companies were playing a risky game by seemingly ignoring economic issues in favour of political ones and by concentrating on the wider European Commission, and in doing so going over the heads of the European Competition Commissioner Joaquín Almunia and his team.

The two sides presented the tie-up as an opportunity to create a Europe-based powerhouse able to take on the might of US exchanges such as Nasdaq and the Chicago Mercantile Exchange. However, they neglected the pure anti-trust arguments within Almunia's purview. At the same time, as part of the commission's investigation, rival exchanges made convincing submissions to the Competition Commissioner that the deal be blocked, or only approved on the basis that the newly combined NYSE Euronext/Deutsche Börse firm would commit to make massive divestments in the areas where it would dominate.

By the time the European Commission came to a formal decision, the US anti-trust authorities had already cleared the merger (albeit with some conditions), which was no small achievement for the companies and their legal teams. However, despite a year-long campaign by the two chief executives, the European Commission officially vetoed the deal in early February 2012, following a recommendation by Commissioner Almunia. Despite the support that NYSE Euronext and Deutsche Börse had from a cabal of European Commissioners led by Michel Barnier, French Commissioner overseeing financial regulation who backed the national champion argument, it was not enough. The commission, as it invariably does, ultimately supported the ruling of the Competition Commissioner.

Almunia told *The Financial Times* in an interview that the two companies had used the wrong approach. "They tried a public relations campaign, lobbying, political pressure to get a positive decision. I told them from the beginning 'you don't know how to deal with the commission.' This is not the best way to convince us - quite the opposite, it is the wrong way." In summing up why he opposed the merger, Almunia left little room for doubt: "The deal would have led to a near monopoly in European financial derivatives worldwide."

Niederauer admitted that he had misjudged the Competition Commissioner's investigation into the market, which Almunia always insisted be considered on a pan-European, not an international level. One senior person close to one of the two exchanges told *The Financial Times*: "Duncan has good relations with a lot of top European officials, including [International Monetary Fund managing director, Christine] Lagarde, and I think he thought he'd be able to persuade Almunia. But that was not going to work with Almunia."

Angry at the decision, Deutsche Börse threatened to take the European Commission to court to try to reverse it. Even after NYSE Euronext decided to walk away from the failed merger on the basis that a challenge would mean a protracted and expensive legal campaign, the German exchange insisted on pursuing its case, lodging it with the European Union court in 2012.

When it came up for review in March 2015, the Deutsche Börse contended that the European Commission had not adequately considered that some merger efficiencies would have benefited customers, counteracting the negative impact of competition. They further argued that the commission had not properly taken consideration of the remedies it proposed, such as offers to sell off parts of the merged entity.

However, the General Court, the EU's second highest authority, rejected the case saying the commission had made no legal errors in its assessment of the market. As the European Commission is notoriously difficult to challenge and very few disappointed merger proponents ever try, few observers were surprised this time around.

There was a silver lining for Niederauer, a one-time Goldman Sachs executive. NYSE Euronext was heavily dependent on him to provide it with a new direction once the merger fell apart so it doubled his exit package to two times his salary as part of a pay hike. It also increased his potential equity bonus by $250,000. As to the Deutsche Börse, it launched a bid in early 2015 for it's London-based rival, the London Stock Exchange, in a deal structures as a friendly 'merger of equals'. For the Deutsche Börse, it was a case of hoping that they'd be 'third time lucky', as twice before, in May 2000 and December 2004, the London Stock Exchange had resisted merging or being acquired by the Deutsche Börse.

DP World: Stuck in Port

Even a relatively open economy like the US can resort to anti-foreign bias on occasion as is demonstrated by the fate of the Dubai Port World (DP World) bid for London-listed P&O in 2006. P&O was at the time primarily a ports operator, having recently divested a number of businesses including its cruise ship Princess Cruise line. Its portfolio still included container terminals in a number of major US ports including Baltimore, Miami, New Orleans, New York and Philadelphia.

In a rapidly consolidating global marketplace for shipping infrastructure, the company was a highly desirable target and a bidding war ensued between the Port Authority of Singapore (PAS) and DP World, the growing infrastructure business owned by the government of Dubai. On January 10th 2006, DP World made a bid for London-listed P&O, trumping the previous high bid frin the Port of Authority of Singapore, owned by the government of Singapore.

As the battle escalated, both sides moved to put in place the necessary regulatory permissions, the most important of which was an application to CFIUS, the bi-partisan political body that regulates overseas investment in the US.

At the time, CFIUS had the power to either approve a foreign buyer or open an investigation period to look into it more carefully; its powers have since been significantly bolstered. Historically, CFIUS tended to approve bids but there are some examples when it effectively blocked a deal by delaying it and causing attendant publicity. One such example was a $18.5 bid by the China National Offshore Oil Corporation for US-listed oil major Unocal, which was blocked by CFIUS in 2005.

In January, a CFIUS panel chaired by the Deputy Treasury Secretary and representing the views of the Departments of States, Justice, Defense and Homeland Security voted unanimously to approve DP World's bid for P&O. Had any of the panelists objected, there would have been a mandatory 45 day investigation period and the matter would have been referred to the US President for his personal clearance, but this did not happen.

Opposition to the deal grew as the M&A process moved on and P&O's board and shareholders approved a takeover by DP World. At this time, memories of the September 11 attacks were still painfully raw and the US still had more than 100,000 soldiers stationed in Iraq. Although Dubai, and the wider United Arab Emirates (UAE) of which it is a part, were key Middle Eastern allies in the US' War on Terror, Dubai also had some links to Al Qaeda: two of the 9/11 terrorists were from the UAE and some Dubai-based intermediaries had been involved in financing the plot.

The Bush administration tried persuasion to get the deal through, stressing the importance of the UAE to US interests in the Middle East and assuring the country that Gulf ownership of American infrastructure assets was perfectly safe. But critics of the deal, including Senator Hilary Clinton, drew no distinction between Dubai and other, less friendly, regimes in the region and continued to object. On February 22nd, the President threatened to veto any legislation Congress introduced the block the deal, but neither presidential persuasion nor force dampened the growing storm.

In this volatile environment some of the criticism of the deal was considered, linking security objections to allegations of cronyism by current and former members of the Bush administration, which

had close business links to DP World. Other comments, such as on CBS' 60 Minutes, one of America's most-watched TV news shows (see box below), bordered on the racist and jingoistic.

Andy Rooney, Dubai Ports, CBS' 60 Minutes, March 24 2008

"A lot of Americans are concerned that it [the Dubai Ports takeover] might be a security risk. Security isn't what matters to me. What I don't understand is why the hell we can't run our ports ourselves. Too hard for us? Aren't we smart enough?"

….Too much of our work is being outsourced. Why don't they outsource the White House? Or Congress? Get some really smart people from other countries to run ourselves for us. A Congressman gets about 162,000 [dollars] a year and all he can eat. I bet we can get some natives of Dubai to do the same work twice as well for half the price."

I hope CBS doesn't decide to outsource *60 Minutes* and get someone from Dubai - Anwar Rooney - to the work for a quarter of what they pay me."

On February 27, in an attempt at damage limitation, DP World itself requested a 45 day CFIUS investigation. But by this point US politicians were asking for more. On March 7, Jerry Lewis, the Republican Chairman of the House Appropriations Committee, said: "It is my intention to lay the foundation to block the deal." The next day his committee voted in favour of an amendment to do just that.

On March 9, DP World capitulated, announcing a personal decision by the ruler of Dubai, Sheikh Mohammed bin Rashid al Maktoum to "transfer" P&O's American assets to a US-owned entity. Eventually the assets were sold to the asset management division of American International Group.

Reaction in the Arab world was furious. "People, businesses as well as the government of the UAE are deeply offended as a result of the ports deal fiasco. People across the UAE are angry to the extent to which their moderate and open country has been demonised by the American media and lawmakers in Washington," said political scientist Abdul Khaleq Abdullah in a column in the Dubai-based Gulf News on March 17th 2006.

The decision was both a foreign policy problem for the administration and, in the longer term, a stain on the country's reputation as an open economy. It also had a big impact on US policy, leading to the Foreign Investment and National Security Act of 2007, which greatly increased the power and jurisdiction of CFIUS.

But is there anything DP World as a bidder could have done to avoid the fiasco that unfolded? Possibly. There were clear errors in planning and communication, two of our Three Big Mistakes of Deal-making. DP World made little attempt to "warm up" or lobby the broader body of US lawmakers or the US public to the possibility of the ownership of American ports by a friendly Gulf nation.

A poll of Americans at the time revealed that they cared a lot about the nationality of port operators. While only 26 per cent thought the Federal government should not allow companies from the UK to own cargo operations at US ports, according to a Gallup poll, 50 per cent would ban the French, 56 per cent any Arab country and 65 per cent China.

Any campaign to alter public opinion would have to have been long-running and persuasive to change such ingrained prejudices. But a well-planned PR and lobbying campaign that focused on the neutrality of DP World's arms-length corporate ownership and reinforced the benefits of a merger might have had a chance of success.

What actually happened was that DP World, much like Deutsche Börse in other example, thought they had regulatory clearance sewn up thanks to strong connections to the government, or in the case of Deutsche Börse, the European Commission. DP World did not even hire a lobbying firm until late on in the process when it sought to sway Congress to its side. However, it was probably just too late.

Since the turn of the millennium, the likelihood of deals being blocked has increased significantly in Europe and the US, while emerging markets race to keep up with Western regulators. In 2015 alone US competition regulators had a bumper year, blocking Comcast's $45 billion acquisition of rival Time Warner Cable, Tokyo Electron's $30 billion takeover of US chipmaker Applied Materials and Electrolux of Sweden's $3.3 billion bid for General Electrics vacuum business. Regulation is here to stay.

Beware the Regulator: THE DOs AND DON'Ts

- **DO remember that even if shareholders agree to the deal, it can be stopped by the government**
- **DO know who in the government is making the final decision, whether it's regulators or politicians**
- **DON'T assume that the takeover rules are the same in another jurisdiction**
- **DO abide by the rules once you know them**
- **DON'T forget communication is key with regulators – and with influencial politicians and the public**

0.9. Doing the Deal Right

Franklin D Roosevelt took office as the President of the United States of America in the depths of the Great Depression. Finding the ravages of several years of runaway employment, deflation and falling output, FDR knew he needed to act quickly: between March and June 1933 he introduced a raft of measures to prime the pump of the US economy, including the Glass-Steagall Act, which safeguarded the financial infrastructure of the country through the legal separation of commercial and investment banking until it was repealed in 1999.

FDR's so-called New Deal might be a little too Keynesian for the tastes of some in business today, but the method by which the policy was implemented was the political forerunner of a major corporate concept: the first 100 days. The 100 Day turnaround timeline - which can be traced back to Napoleon Bonaparte who returned from exile, re-instated himself as the ruler of France and declared war on England and Prussia before capitulating at the battle of Waterloo just over a hundred days later - is used across business by incoming executives and owners to provide a structured action plan that puts a company on the front foot. It is a fundamental part of M&A strategy.

Successful M&A - and the beneficial impact on the wider economy that we discussed in the preface to this book - starts with doing the right deal, at the right time. The second part of the equation for success, which we will consider in this section, is 'doing the deal right'. The latter typically attracts less attention and scrutiny than the former, but is, in our experience, where real value can be added or destroyed, irrespective of the rationale for the deal.

While the 100 Day Plan is corporate shorthand for deal integration - and a key part of it - it is by no means the whole. Deal implementation begins with the disciplines we discuss in earlier sections about where you formulate a merger strategy in line with your company's overall strategic aims and rigorously target acquisitions that can deliver this. Determining if you have the capacity to spend the time and resources on integration should be part of the planning as discussed earlier. More specific post-closing planning for the integration should begin as soon as a target is identified and should be an intrinsic part of drawing up a list of target companies. After all, how can a deal be costed and its benefits and synergies assessed unless you have at least a skeleton integration plan? This section should be read in conjunction with the earlier section on due diligence, which if done properly, will provide the foundations for the integration of your new business, highlighting any particular issues that may arise in terms of culture, people, processes and indeed almost every aspect of the newly-combined businesses.

As should be clear from the above, a deal's longer-term success depends on what is done on integration throughout the deal process including during both the post announcement and post completion periods. Particularly important is whether planned synergies have been captured and staff morale raised as quickly as possible to realise the deal's potential. In times of economic uncertainty and low growth, delivering the full and promised value of acquisitions becomes even more important. Success of a transaction is often defined by the ability to deliver the promised synergies, either of revenue or cost, and to implement a change in operating model. This is crucial and applicable to all sort of sizes – small, medium size and large - and types of deals – public or private, including deals amongst charities.

For an excellent example of the latter, look no further than the Royal National Institute of Blind People [RNIB]. On 1 April 2009, RNIB formally announced that Action for Blind People [Action] had become the third member of their sight loss group alongside National Talking Newspapers & Magazines and Cardiff Vales and Valleys, the first three of many more in RNIB's consolidation of related charities in the UK. The formation of this group cemented RNIB's position as the number one sight loss charity in the UK.

The driving force behind the 'mergers' was both financial and political but the vision behind the group came from RNIB's CEO, Lesley-Anne Alexander, CBE, who felt that having over 700 charities in the UK seeking to achieve the same objective was counter-productive to achieving their charitable objective of providing the best possible support for blind and partially-sighted people.

RNIB recognised that there could be significant synergies in these mergers as, for example with this deal, the services provided by Action, which were primarily community-based and in England, would complement its own services, which were based either principally nationally or specifically in Scotland, Northern Ireland or Wales. The combination would therefore cover all of the regions of the United Kingdom, thus enabling it to gain maximum return from its increasingly difficult quest to raise resources.

As such, the decision to combine operations was made and a five-year partnership deal was entered into. The deal comprised Action taking on responsibility for all of RNIB's and Action's regional and contract services and staff in England, whilst RNIB took over fundraising for both charities. The deal reflected the fact that front office operations were to merge but back offices were to stay separate.

Alexander said more about realistic achievement of the synergies and benefits of their merger:

> Before we did anything with Action we had 0% of the benefits of the merger, and possibly if we had done a traditional takeover and merged completely the front office and back office, we would have got 100% benefit. I estimate that with the new structure we achieved about 50% of the benefit. In my book, 50% is a whole lot better than 0% and the door is open to increase from 50% as time passes.
>
> That benefit is derived from blind and partially-sighted people having one place to go for their services, on the high street in Liverpool, Birmingham, Bristol and Manchester, and all those other places where we have a presence. Everyone says economies of scale can be derived from merging back office activities but that was not on offer and I was not going to be prevented from merging front office – the real places that real blind and partially-sighted people visited – because I could not have it all! I can put up with back office complexity if that is the price we are paying for making the landscape simpler for our service users.

Crucially the pre-completion integration phase also operates as a canary in the coal mine for your deal. If the headline integration plans - such as the selection of an executive board team - are coming unstuck, this is definite signal to walk away. Similarly, if the market shifts during the negotiation phase, this might be a last opportunity to get out and avoid the sort of corporate Armageddon experienced at the Royal Bank of Scotland.

Integration can mean a complete blending of the two businesses from executive level downwards, or as completely separate businesses, common with private equity portfolios, or anything in between. What matters is that the post-closing phase be properly planned and that the rationale for buying the business be implemented in expertly rendered fine detail.

Broadly, the integration process can be broken down as follows:

- Phase One: Pre-Closing
    - Stage 1: High level merger planning. Discussion restricted to a very small group of senior level executives representing the key areas of integration, avoiding leaks
    - Stage 2: Announcement. The expectations of management and employees should be carefully managed from the outset. At least the top level of management, if not the second tier, should be in place by announcement.
    - Stage 3: Informal integration can begin. The more uncertainty, the more unstable the target organisation will be. It may be essential to begin the combination of particularly

challenging systems, such as major IT and HR systems, at this point, if possible, but not at the very least to be planning for these.

Or, if the negotiations turn sour at this point, be prepared to walk away.

- Phase Two: Post-Closing
    - Stage 4: The 100 Days - the key window to set up the right foundations for integration.
    - Stage 5: Stabilisation and organizational andcultural integration. This is a long-term process and can require several years to finalise; the journey is complete when employees, customers, suppliers and investors consider the combined company to be "business as usual" and when few refer back to the legacy organisations; a good rule of thumb is that this stage should not last more than three years, and ideally be much shorter.

As a deal moves towards completion, the corporate team steering group is likely to change, with new personnel - either in-house or external advisors - taking over from the deal negotiation team. However, it is important that communication and handover between the teams is good with at least some executives providing continuity or work alongside each other for a specific time period. Disconnects between the two teams can be and is often one of the biggest impediments to the proper implementation of the developed integration strategy.

As well, throughout the process, management needs to remember that their biggest challenge may not be the integration but making sure that employees keep the core businesses running successfully.

Phase 1: Giving diligence its due

Good integration begins with good due diligence that means using an "issue led" approach to identify and address the key issues at the outset, instead of falling back on a compartmentalised box-ticking approach of separate tax, financial, legal and other assessments. Time and time again we have seen companies pay for due diligence (advice), then throw it away once it has been used to establish price..

Comprehensive due diligence information should be used to provide a blueprint for the post-deal integration that will allow a buyer to maximize its financial and strategic goals and avoid the identified pitfalls that have been uncovered. In this way good due diligence should easily pay for itself. This blueprint of the merged business should set out the key elements of its new strategy, re-iterating the value drivers for the deal outlined when the target was first selected.

The merged company should have a very clear idea early in the deal process of what they will do differently compared with the target's – and perhaps even the buyer's - former business plans. Once this is identified, the CEO – and yes, it needs to be led throughout from that level of the firm – should comprehensively allocate responsibilities to selected senior managers so that it is very clear to all who has the responsibility to implement the plan. This needs specific timeframes and milestones and should be clearly linked to management performance targets and assessments.

Once that is done, management should develop a clear Day One plan that will ensure how the new combined organisation will start to operate from the outset. Despite the point we made earlier about a damaging disconnect between deal negotiation and implementation teams, it can - provided there is sufficient oversight - be advantageous to use a "clean team" comprised of both internal staff and external advisors to prepare this plan. A clean team will operate between both organisations and develop integration plans and business cases consisting of commercially sensitive information which normally could not be shared between announcement and completion phase of the deal. This is

particularly the case where there is a hiatus between deal recommendation to the stakeholders and the date of closing, for instance where there is a lengthy regulatory review.

This Day One plan should also be designed with maximum flexibility in mind, as better information will be available in Phase 2 below and therefore the integration plan should allow for changes using that new data. This is also the point, if your deal is not going to plan, that you need to consider whether to press ahead or alternatively cut your losses and step aside

Phase 1 Off the Rails: Stopping Runaway Trains

By the time a deal is nearing completion, a buyer's management team will have invested months, or possibly years, of executive time in planning the takeover. They will have paid advisors and may have arranged deal financing. In such a situation the momentum behind an acquisition will be such that the team will feel the only possible way is forward.

But the best chief executives will be able not just to spot a losing hand, but have the courage to fold when necessary, even if they have taken a big financial gamble on an acquisition. The Omnicom - Publicis merger we outline below descended into ever more public rows about board representation until it was called off in 2014, clearly picking up on a classic sign that a deal had not been properly thought through. Trains tend not to fall off the tracks with no warning. Here, as is often the case, failures in strategy - and most importantly in due diligence - are what has unbalanced the carriages.

Holding hands across the Atlantic

When Paris-based Publicis Groupe and New York-based Omnicom Group announced their $35.1 billion merger in mid-2103, they raised the tantalising prospect of an advertising marketing giant that would combine the accounts of global super-brands such as Pepsi and Coca-Cola and provide real competition for the sector's biggest player WPP.

According to the Financial Times this rare "merger of equals" began with a joke. Omnicom's chief executive John Wren was visiting Publicis' Paris headquarters in 2013 when he paused to admire the outstanding view from the rooftop, which overlooked the Arc de Triomphe. Maurice Levy, Publicis' chief executive and Wren's long-time rival, replied: "It can be yours," and with that the idea of the deal was born.

The combination of the two listed businesses seemingly made perfect commercial sense. In an era where massive new internet and social media players – such as Google and Facebook - typically wanted to work with agencies close to their own size, smaller scale businesses felt that business was passing them by. A merged Omnicom-Publicis would have been much larger than rival WPP with US revenue alone of $11.4 billion - twice as much as that of WPP - and would have been in pole position to deal with the new media and technology giants. Even the timing of the merger was perfect; in 2013, advertising was finally emerging from the slump it fell into during the financial crisis and subsequent recession.

Yet by the time the deal was announced in July, talks aimed at coming up with a management structure for the new business were already stalling. The two companies are "people businesses" whose job it is to be emotionally intelligent and sensitive to clients' needs. It is more than possible, however, that they forgot that in their own deal when doing proper due diligence that consideration of these human factors is absolutely vital. Corporate culture and the ways of working/operating are often overlooked during the due diligence process, but it is on this rock that takeovers can crash. It is vital that executives consider the “soft” cultural issues as they are often outward manifestations of very different management styles, ways of working and an indication of how far power is devolved within an organisation.

Within the advertising sector, Omnicom and Publicis - and their two chief executives - could not have had more different corporate cultures. Wren, an American, was a former accountant who kept a low

profile in a glamorous industry while Levy, according the Financial Times, was a European charmer with a real year-round St Tropez tan. These different styles, likely reflected deeper in the two organisations, are issues that should have been identified early on in the due diligence phase and an action plan drawn up to deal with them.

What actually happened was that the two men agreed the most important jobs at the business - their own - as a precondition to a merger. They would share the job of chief executive for the first 30 months, then Levy would step up to the role of Chairman. However they did not go much further. In most mergers, it will be important to identify most or all of the top level executives at the outset. This is particularly true where the deal involves people businesses where human resources are the companies' biggest asset or where management has specialist expertise that is crucial to the success of a merged business (witness the example in earlier sections of the HP purchase of Autonomy). This is doubly true where the two businesses are similar in size and power and therefore where the "merger of equals" idea is real, or close to it. We saw a similar issue in an earlier case study where Britvic and A.G. Barr decided not to restart their merger talks in part because they could not agree on board roles.

The flashpoint came for Wren and Levy over who got the role of chief financial officer. Both men wanted to make this crucial appointment and realised it was key to getting their vision imposed on the overall business. Because the culture of the two businesses was different - Publicis was very centralised and Omnicom very devolved - this was a particularly important appointment. Claudio Aspesi, an analyst at Bernstein, said "It was only human for both CEOs to want their trusted staff around them but you can only have one CFO."

But according to Levy, Wren also wanted to bring across his general counsel, meaning the two most important financial and legal functions of the Franco-American business would be filled by Americans, an outcome that was culturally sensitive for the Paris-based Publicis. "The balance was not being respected," Mr Lévy told the Financial Times. "He wanted to have his CFO as CFO, and his general counsel as general counsel. So as you can see, the key positions of the holding company would have been in the hands of Omnicom people and this was unacceptable. "A number of tax and regulatory issues also raised their heads and, in 2014, the two sides called the deal off.

In a joint statement the two CEOs said: "The challenges that still remained to be overcome, in addition to the slow pace of progress, created a level of uncertainty detrimental to the interests of both groups and their employees, clients and shareholders. We have thus jointly decided to proceed along our independent paths. We, of course, remain competitors, but maintain a great respect for one another." Levy said separately that Publicis founder Marcel Bleustein-Blanchet would have "turned in his grave" over the proposed merger and that his company would stay single.

Other Obstacles on the tracks

Some deal processes should just never have been started. But what should you do when the market shifts around you in a way that you hadn't - but should have - anticipated or perhaps that could not evenhave been foreseen, the proverbial 'black swan' event. In the standout example of the former, in the banking sector, RBS pressed on with its ill-conceived pursuit of ABN Amro as the financial storm clouds gathered in 2007 after its rival, Barclays, gave up on the deal.

With oil prices falling thanks to falling demand and the impact of new North American sources on supply, how will consolidation in the energy sector be affected over the next decade, and have deals already in the pipeline been affected?

Any number of deals have quite rightly been called off because markets, including the competitive environment, have changed since the deal was first conceived. If, for example, RBS' chief executive

and board had been less driven by ego and more driven by the markets, the bank could have avoided the disastrous takeover of ABN Amro discussed earlier in this book.

The merger mania that hit aluminium and iron ore producers, including Rio Tino and Glencore Xstrata, did not look as well conceived following the collapse of commodities prices; the commodities super-cycle theory beloved by Rio's Tom Albanese and others turned out to be subject to exactly the same cycle of boom and bust that has always governed the economy. BHP Billiton had what may have been a lucky escape from some of the fallout from the collapse of commodities prices because it abandoned its 18 month pursuit of Rio Tinto in 2008 just as the downturn began.

The decision to drop Rio was, in part, due to hostility of Chinese regulators to the deal, in part due to shareholder opposition to it and in another part due to turbulent markets that made it difficult for BHP to secure the financing for the takeover. In this case, they listened to outside signals.

When BHP walked away, however, the company blamed the collapse of its transformational merger on end of the super-cycle. "This decision is set against the global economic crisis and its impact on our assessment of its benefits... I think the commodity prices across our suite of assets and for most of the other players have gone down by 50 per cent over the last six weeks. It has clearly impacted our cash flows already," BHP CEO Marius Kloppers is quoted as saying by the *Wall Street Journal*.

Hitting the political sidings

The world's regulators and politicians have a large and growing influence over the fate of the biggest and most important deals. In many cases there is simply no getting around the regulator especially - as we saw with Danone - if the politicians in question are French and believe their nation's army marches on its yoghurt. This sort of overwhelming opposition to a takeover simply cannot be fought, or a least not without a campaign over decades or some hefty political influence.

Many companies will wish to "kick the tyres" to establish how far they can push expansion and will do so in the full knowledge that they will have to spent money on advisory fees and time on an exploratory deal to get a firm answer to their questions. The difference between those who have a good M&A strategy and those who do not, is that the former know when to walk away.

In 2012, two of the world's defence and aerospace giants, London-based BAE Systems and Paris-based EADS, had a tilt at a merger that would have catapulted them into the same league as US giants like Boeing and Lockheed Martin. The tie-up faced huge political and regulatory hurdles from the outset; the UK, Paris and Germany all have stakes in the businesses while even the US, BAE's biggest client, took an interest in its ownership. A month later the two companies called the deal off saying: “It has become clear that the interests of the parties’ government stakeholders cannot be adequately reconciled with each other or with the objectives that BAE Systems and EADS established for the merger.”

The two sides had managed to agree on strategy, management, and even dividends. They had initial support from the UK government, which had a golden share in BAE that allowed it to block a deal if it wished, and traction from the French government which owned 15 per cent of EADS. But they had failed to convince Germany, which held a stake in EADS through Daimler, the car giant.

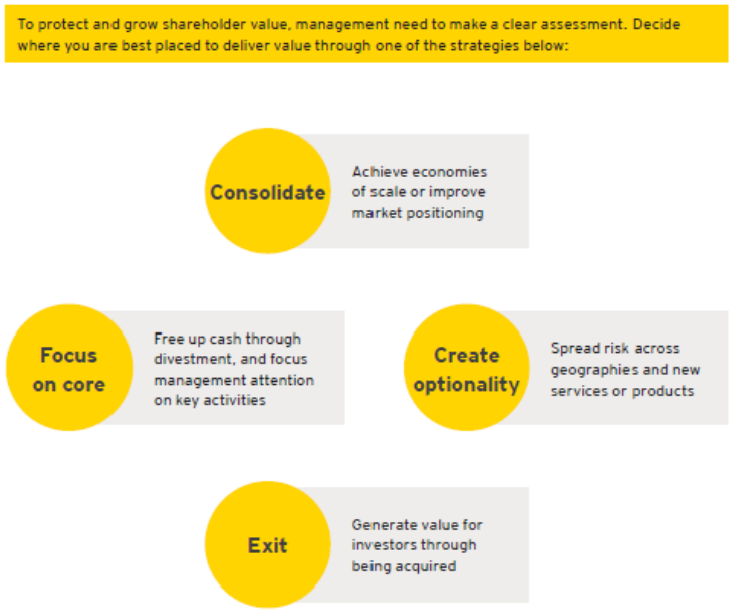
On one interpretation, the deal’s collapse was a failure, and could have left BAE vulnerable to unsolicited takeover bids. However, on another, the companies managed to close down one avenue quickly with little loss of management time or damage to their reputation. Contrast this with Deutsche Börse who fought to the end - and beyond - in an attempt to force regulators to back its merger with New York-based exchange NYSE. Where there is real regulatory risk, knowing when to cut your losses is crucial.

However, dramatic market movement alone should not necessarily mean that a deal should be

abandoned. In fact falling prices can be a driver to industry consolidation. Oil prices fell by around 50 per cent from the middle of 2014 to the end of 2015, but against this backdrop the oil and gas industry has seen a wave of consolidation. The trend echoes what happened when oil prices were similarly depressed in the late 1990s, a period that saw BP join forces with Amoco and Arco, Chevron combine with Texaco and Exxon with Mobil. According to the Financial Times, private equity firms including Carlyle and Blackstone have in parallel raised billions of dollars to spend on oil and gas acquisitions in expectation of corporates disposing of non-core assets.

The guiding principle when making tough decision should be look back at the original deal rationale and due diligence. Will a merger still deliver the strategic wins identified? If the answer is yes, pushing ahead may be the right thing to do. If not, you should have the courage to walk away. Again, this is no different for a small or medium sized company that is undertaking a deal. Reassessing and walking away is as important for smaller companies or private equity firms like the Gores Group

Figure 0.9-A: What strategies are available?



walking away in 2012 from the auto and parts repair company Pep Boys. In that deal, despite nearly two years of discussions with Gores and others, the buyer decided that poor financial results in the target meant that the deal could not proceed.

Phase 2: Day 1 of the 100 Day Plan

In a takeover situation the buyer will never have access to all the information it would like. This is particularly true in a public deal or a hostile deal where access to proprietary internal due diligence is very limited if not even non-existent.

Following completion however - as the proud new owner of the target – the acquirer can re-calibrate its original deal rationale against a whole new set of data. From then on, it will be able to review integration plans against the real numbers and facts while the 100 Day integration plan is being implemented. Reviews should be regular and often, allowing management to monitor progress against the original drivers of the deal.

In most deals, the delivery of synergies - defined as the financial benefits of cost savings and revenue growth attributable solely to the combination of two previously-separate companies - will determine the success or failure of the enterprise. Many buyers will already have outlined a timetable for the achievement of synergies in pre-close conversations. In the UK and some other jurisdictions, this description and quantification of savings is even required in the formal merger documents filed with the regulators for public companies.

One technique for determining synergies is “triangulation,” a process that evaluates identified synergies (cost and revenue) and compares them against the historical delivery track record and external industry-specific benchmarks. By comparing the identified synergies in this way, they receive substantial indication of the robustness and quantum of the identified synergies.

Our experience suggests that stakeholders, such as financial institutions, have three key questions:

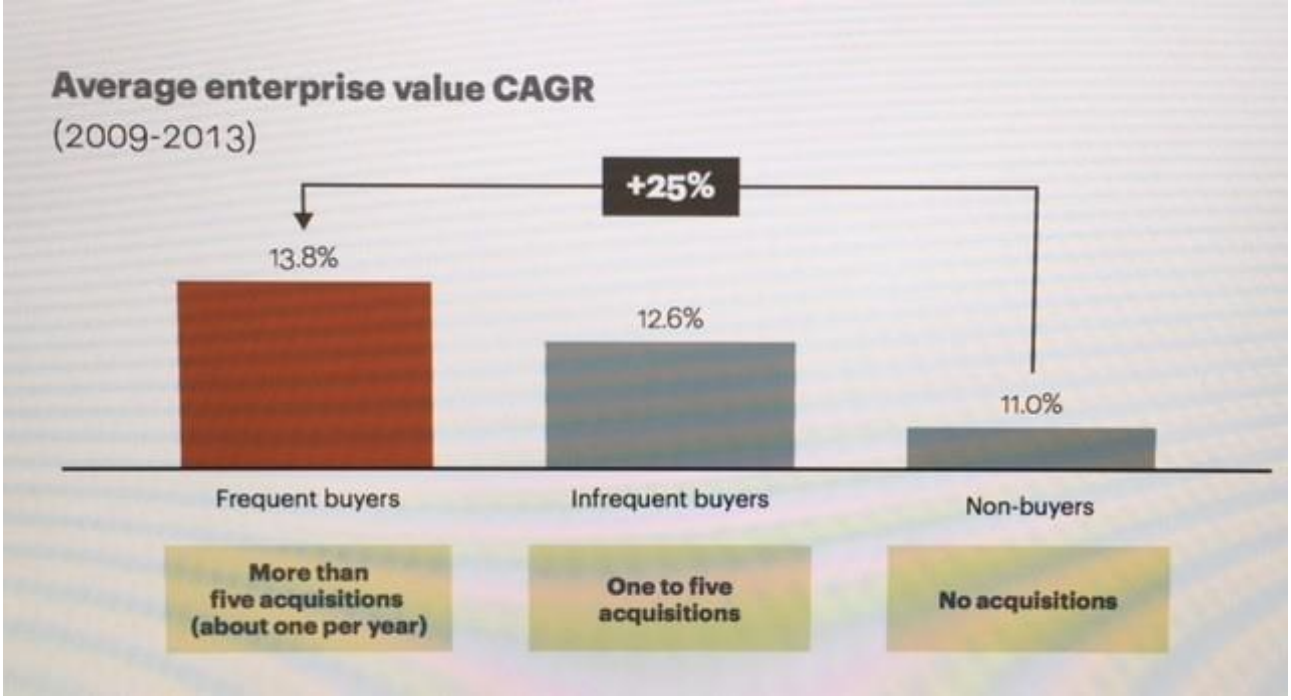
1. How much are the synergy benefits worth? Are they cost or revenue based, or both?
2. When will the synergies be delivered? Transformational change should be done at a reasonable pace to extract the maximum possible overall benefit.
3. To achieve those synergies, what one-off costs are estimated in the integration program? Has management completed a robust analysis of these one-off costs required to deliver the identified synergies (cost and revenue)?

Once this has been established, synergies should be made a priority part of the integration plan, with internal targets often 20-30 per cent higher than those made public – the ‘under promise, over deliver’ point discussed as a PR tactic in an earlier section. As well, the costs to achieve those synergies – often requiring pain to the organization in terms of employee redundancies and the closure of plants or business lines – should be taken early. Delaying the inevitable doesn’t make it easier and may indeed make it more expensive,

Of the factors that determine whether M&A adds or destroys value, integration is arguably the most important, although it is possible for an acquisition to be a huge financial success even if it is never integrated into the parent company. What is important is that the rationale for the deal is sufficiently well enunciated ahead of the deal in order to determine properly what the post-deal operating business model of the combined organization will be.

Unsurprisingly it is clear that serial acquirers are better at integration as well as at target selection. In a report issued by AT Kearney in 2016, they found that 'the enterprise value growth rate of serial acquirers [who did more than five deals per year] is 25 per cent higher than the growth rate of companies that had no acquisitions. The stellar examples we consider earlier certainly fall into this category - from Diageo’s emerging markets targeting triumphs to CKI’s due diligence machine. Time and again, we see that buyers who get the fundamentals right have the tools they need to continue building post-deal integration and beyond.

Figure 0.9-B: Serial acquirers create value faster than other companies



Getting it right: the Centrica way

When Venture Production grudgingly accepted defeat in 2009 in its battle to thwart a £1.3 billion takeover by Centrica, the history of the tussle did not bode well for a successful integration.

Centrica, the UK's biggest utility company whose Chairman, Sir Roger Carr also was Chairman of Cadbury during the takeover battle with Kraft, had acquired its new division by way of a hostile takeover bid in which it appealed to Venture's shareholders in the teeth of strong opposition from the company's management. Even when Centrica captured 50 per cent of the company's shares and its board finally recommended that investors accept Centrica's 845p a share offer, Venture's management continued to insist that the Centrica offer undervalued the company.

Unusually for a hostile takeover, Venture Production's executives - or at least those below the CEO level - were key attractions for Centrica. Venture was a successful start-up where the board and management were significant shareholders. While the Chief Executive and Chief Financial Officer, who together led the bid defence, were expected to retire along with the company's founders, Centrica was very keen to hold onto Venture's operating management.

At the point when it became clear that shareholder's acceptance would reach the 75 per cent threshold to gain even greater control of the company, Centrica brought in an external team of advisors to help with the integration.

Early planning combined with good communication helped Centrica to tie down one of its target's most important assets: people. A team of advisors developed a plan to approach Venture's staff with a clear and consistent message. At its core was a promise to Venture's

highly entrepreneurial executive team that if they stayed on after the takeover, they, not Centrica's upstream gas division with which it overlapped, would be in charge of that merged business. The Venture team found the seniority of the people talking to them and the consistency of the messages impressive.

Centrica was prepared to invest management time into the initiative in addition to money spent on advisors. The utility giant's then Chief Executive Sam Laidlaw spent three days speaking to executives both as a group and individually in an attempt to convince them to stay on. Good communications cut both ways and the executive in charge of Centrica's existing upstream business was told immediately that he would be made redundant as a result of the deal. In return for this respectful treatment - and a generous severance package - he stayed on to help manage the integration.

As a result, just under 10 per cent of Venture Production's employees left in the wake of the takeover and nearly all of those were back-office staff who were made redundant because their functions were duplicated inside Centrica. Also crucial to retaining talent was the upfront decision to move the head office of the newly merged upstream business from Centrica's divisional headquarters in Woking, near London, to Venture's HQ in Aberdeen, Scotland where many of Venture's staff worked and lived.

The move also helped to define the culture of the new organisation. Centrica had the reputation of being a big, slow, bureaucratic company that would crush any entrepreneurial spirit. But working with its new parent company, the team from the Venture Production side was actively encouraged by Centrica and able to help design an approval processes that ensured the newly-combined organisation would operate better and more efficiently than previously. For example, new procedures ensured that the merged business - which was called Centrica Energy - could make a decision about capital investment within only three weeks of receiving a request, in line with Venture's practices before the merger. This was visible demonstration that the entrepreneurial culture of Venture would be maintained under Centrica ownership.

The Centrica Energy integration was particularly unusual because it was done without that business having a CEO. Jonathan Roger ultimately took up the role on completion of the integration. The integration was done using a detailed milestone plan of just four months from a standing start to complete merger. This was one month longer than the normal 100 days we refer to in the book but after the four months the new organization could operate already on a 'business as usual' basis. In that time the business consulted employees, moved head office, rebranded with a complete name change and introduced a new set of financial controls.

One of the external advisors for the deal, David Overd who worked on the integration, said that "one of the most important factors was that we all knew what we were supposed to do by a given date and nobody wanted to be late. Nobody missed a deadline in the whole four-month period, which created a fantastic momentum."

Crucially the integration also had the full commitment and support of Centrica's leadership team, which was involved from the outset in employee communication. But in addition to having top-level buy-in, the integration plan also saw decision-making delegated to the right levels with a steering group directing individual project teams on areas such as IT and HR.

In terms of relative size, this was a small deal for Centrica that at the time of the transaction had a market capitalisation of around £26 billion. Therefore, the focus during the integration was not on the cost-cutting redundancies, an integration strategy that tends in other deals to make this phase more painful and difficult. Venture Production was instead an important strategic investment for Centrica, at the heart of Centrica's longer term strategy for securing greater energy supplies to meet growing consumer demand.

Getting it wrong: the Zain way

But not everybody gets it right and even the best business concepts can fail because of poor integration. The idea behind the expansion of Zain, formerly the MTC Group, was better than average; in fact, it was very good.

In a nutshell, Zain and its chief executive Dr. Saad Al-Barrak - affectionately known by his staff as "Dr Saad" or, more simply, "The Doc" - realised what any student of the colonial history of North Africa and the Middle East knows: that many of those post-Colonial national borders drawn in the wake of World War I are wholly artificial.

For Dr Saad, this simple concept inspired his approach to telecommunications consolidation in the region. In the first decade of the 21st Century, Africa, and to some extent the Middle East, was making a giant leap in telecommunications, leap-frogging fixed line telephony, which was expensive to install and rare, and taking customers straight to mobile.

Thus, although sub-Saharan Africa remained at the periphery of global markets, it was growing fast, with GDP increasing by six per cent per annum thanks to the global demand for natural resources and with it, rising commodities prices. Indeed, with 800 million people, it was the world's fastest growing market in the mobile telecommunications industry, with the lowest telecom penetration rate in the world.

Many Africans, especially from the nomadic tribes, regularly crossed national boundaries taking their mobile phones with them. This was, and is, especially the case in sub-Saharan Africa. Cheap Chinese handsets were combining with cost-cutting at global giants such as Motorola and Philips to open the market up even further. By the time Dr Saad came along, it was ripe for exploitation.

Dr Saad had helped MTC grow from a single country mobile operation in Kuwait to a regional Middle Eastern giant with operations also in Bahrain, Lebanon and Jordan. In 2005, Dr. Saad was thinking about further expansion into Africa, the hot new market for telecommunications. Meanwhile one of the continent's biggest operators, Celtel, was run by his friend Mohammed "Mo" Ibrahim who had a group of committed investors including International Finance Corporation (IFC) and Actis Capital, an arm of the UK's international aid agency.

Celtel was the largest pan-African wireless service provider with forecast revenues of $1 billion for 2005 and a bright future. As Ibrahim put it: "Everyone thinks Africa is full of starving people and pretty lions. They don't realise that it is also full of normal people who want to make a telephone call." One $3.4 billion merger later (in March 2005) and MTC Group was the owner of Celtel.

For two years MTC adopted a completely hands-off approach to the Celtel operations where the business benefited from MTC's access to and reputation in the financial markets, but there was little further by way of integration. With little pan-African competition, Celtel, which at the point of its acquisition had operations in 11 countries, continued to perform well. MTC helped to fund its further expansion into Madagascar, Sudan and Nigeria.

However, by 2007 the situation was changing as aggressive new entrants from Asia and the Middle East began to compete to transform the mobile telecommunications market. With this increased competition came increased expansion costs. For example, when MTC made its investment in Celtel, it paid the equivalent of $950 per mobile phone subscriber, but less than a year later, when it bought the 61 per cent of Sudan's Mobitel it didn't already own, it needed to pay $1,100 per mobile phone subscriber.

MTC tried a number of special offers to increase its market share, including the introduction of a "Top Up" service that allowed customers to top up credit at major supermarket chains using cash, critical in a region where many potential customers had no credit cards. Its central differentiating strategy, however, was the 'One Network' which provided regional tariffs without roaming charges.

The service, which launched in 2006, was the world's first borderless mobile phone network allowing a region with 160 million people in six countries across East, West and Central Africa to make calls without roaming surcharges. The technology behind the service was relatively simple. More difficult were the required regulatory approvals.

Then came a rebrand, which saw the entire Middle-Eastern-African network become 'Zain', a word which means 'beautiful' or 'wonderful' in Arabic. Dr Saad's ambition was to make the brand one of the world's biggest: a name that could stand alongside Coca-Cola or Microsoft. Dr Saad was not daunted by the fact that no telecoms operator had yet managed to achieve such brand recognition. Zain continued to expand, rolling out the One Network and buying more assets in Nigeria - a crucially large African country - and back closer to home in Saudi Arabia, and then finally, in 2009, in Morocco. By that point, the group had operations in 24 countries across the region. However, the acquisitions had been made at lightning speed with no apparent overall plan and - despite headline-grabbers such as the company rebranding and the One Network concept - by 2010 there had still been very little by way of group integration. Partly as a consequence of poor management and partly because competition in Africa continued to grow, Zain's African operations accounted for approximately 62 per cent of its million customers, but only 15 per cent of its net profit, according to the Financial Times.

With the large networks in Kenya and Nigeria in particular underperforming and the group facing liquidity issues, the Al Kharafi family (its major shareholder) became concerned and began to discuss the disposal of the African network. Dr Saad resigned and was replaced as chief executive by Nabil bin Salama who, later that year, sold almost all its African assets to India's Bharti Airtel, for $10.7 billion.

Zain refocused on its core Arab market and went on to make a very successful push into Iraq, where in 2012 it had more than half of the market. The Financial Times described the company as "the model for the pruned [telecommunications] industry in 2012". That was probably not the legacy that Dr Saad had wanted to have.

As we have seen, the 100 day post-closing period is crucial for the success or failure of a deal in the medium and long term. But it is important not to take a myopic approach to this truncated period. A good acquirer will bring skills and intelligence gleaned in the deal strategy as well as remembering that integration does not end on Day 100. The integration plan should make sure that the newly-combined organisation becomes 'business as usual' as rapidly as possible.

What is the litmus test of success in integration? When the employees stop talking nostalgically about the legacy companies.

When finally complete, it will hopefully be a time of both relief and pleasure that it is over. Sebastian James, following the merger of electronic retailers Carphone Warehouse and Dixons in 2014, told Management Today that during the process 'we were worried it could all turn a bit Game of Thrones – you know swords through the head type problems. But no. We've moved into our boyfriend's flat, we're off the honeymoon period now and have decided who puts the bins out and who does the washing up – the tasks are allocated.'

To achieve this, it is impossible to overstate the importance of early focus of time and resources on this phase of the deal. Where integration is not done comprehensively and effectively, the end result can be the one we discuss in the next section: corporate divorce.

Doing the deal right: THE DOs AND DON'Ts

- **DO walk away where there are a number of very clear signs that you should not do the deal, or that it is starting to unravel**

- **DON’T hang on because you have put so much emotional currency into the deal: it’s braver to walk away than cling on**
- **DON’T underestimate the potential cultural challenges of a merger**
- **DON’T forget that people are the most important business asset**
- **DO be very clear up front about which executives will get senior positions in the merged business.**
- **Don’t forget that you must keep running the current business whilst at the same time integrating the new.**
- **DO take pain early - when you have difficult news to impart it doesn’t get any easier as time goes on**
- **DON’T throw away your due diligence, as it will be critical for developing your 100 Day Plan**
- **DON’T forget the need to get target employees onside early on - or at least be as honest with them as possible; this will benefit the new owner**
- **DON’T stop integrating after 100 days as a thorough merger could take years**

0.10. A Most Amicable Divorce

Even the best corporate relationship does not always last forever. With this section, we have come full circle from corporate strategy, target selection and execution to divestments and spin-offs, some of the strategic alternatives to purchases we considered early in this book.

Mistakes in doing a deal are not the only causes of corporate divorce. Sometimes a corporate relationship that was right in the past is no longer so, as one or both of the parent or subsidiary change their strategy, the market conditions alter significantly, or technological disruption drives fundamental changes in their industry.

There are, however, also a significant number of instances where an acquisition was flawed for one reason or another and subsequently needs to be resold. There are even some where the parent has made a series of mistakes over a longer period and ultimately has little choice but to split itself into two.

Breaking up is, as they say, hard to do. This can be case whether the demerger is done by a full sale to a new owner or by spin-off through a separate public listing, effectively retaining the same owners under separate structures.

Once a split is inevitable, attention needs to be paid to issues as governance, strategy and talent to ensure an amicable break-up, to maximising the best possible sale price and to ensure the continued business of the two companies. This can work well where the acquisition was a fundamentally good one and it is then sold for a substantial profit, as we will see with Mergermarket Group, our main case study for this section.

Why split up?

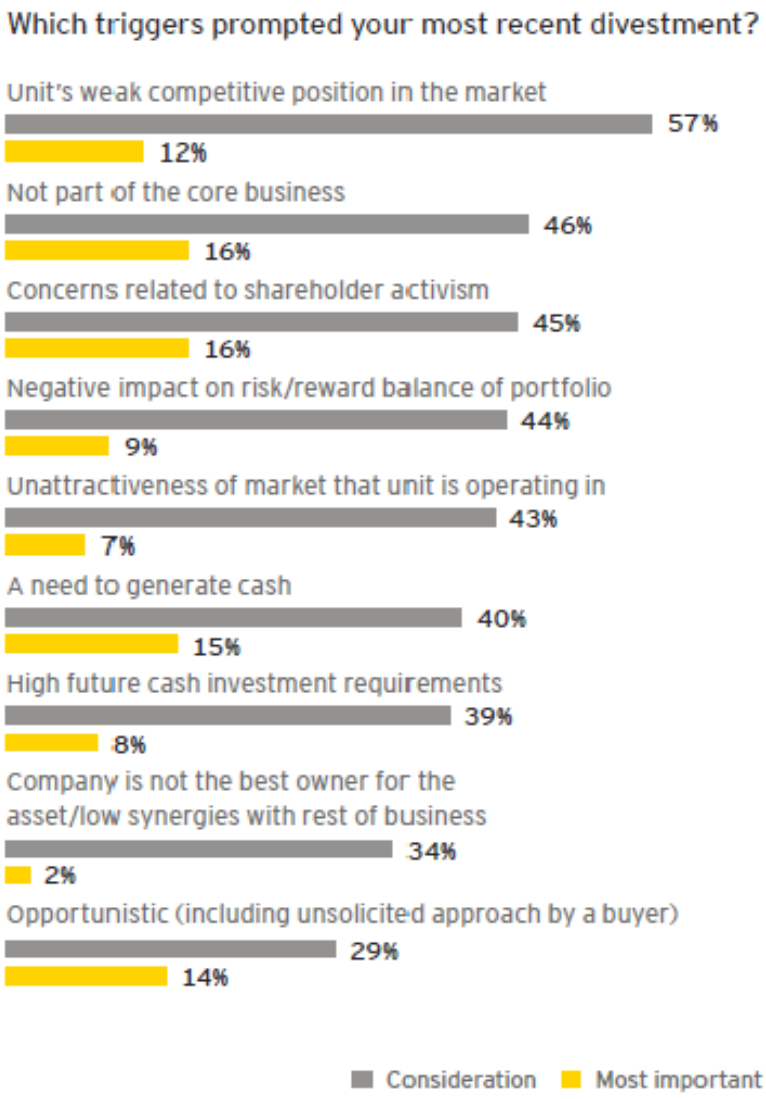
The decision to divest a business need not mean that the original decision to buy it was wrong. Companies often engage in acquisitions which subsequently turn to divested assets. A study by Donald Bergh in 1997 showed that acquisitions of unrelated or non-core assets have little more than a 50/50 chance of being retained five years after acquisition.

This continues today. Following a quiet period of activity during the financial crisis, divestments began to rise again. As the overall M&A market continues to rise, that trend is expected to continue.

A study by EY in 2015 based on 800 interviews with corporate executives of medium sized to large companies found that 45 per cent had recently divested a business or placed one on a watch-list. That study found that 74 per cent of companies surveyed are using divestments, somewhat counter intuitively, to help fund growth, as we saw with Diageo's early disposals.

The growth in shareholder activism is one of the most important drivers of this corporate behaviour for publically listed firms as the activists pressure company boards to make hard strategic choices at a time of persistent slow economic growth or unclear strategic direction. Of those companies surveyed by EY, 16 per cent said that shareholder activism was the most important trigger for their last divestment, while another 45 per cent said it was a major consideration.

Figure 0.10-A: What drives divestments?



A business or division's non-core or weak competitive position will lead to probable divestment, whether pressured by activists or a company's own internal strategic reviews. As we saw in the case of CKI investing in UK Power Networks, many companies go through a continuous cycle of defining core operations and will look to sell divisions to raise cash and free up management resources to focus on operations closer to that core.

However, companies are also increasingly willing to divest for opportunistic reasons. According to that EY survey, 47 per cent said that they would consider selling at a premium of 10-20 per cent were they to get an unsolicited bid. As an acquirer, it pays to be alert for available assets, even if the owner has not put up a 'for sale' sign. This relates to the need to develop a long list of potential targets.

Global macro-economic factors are an increasingly important divestment deal driver. Many of the world's biggest companies are seeking to rebalance their portfolios towards emerging markets, as we saw earlier with Diageo. The status quo has fundamentally changed. As companies realise this and rush to jump on the bandwagon, they will continue to divest their lower growth divisions based in the developed world.

One further point from that study: When economic growth is heading up and valuations are increasing, the need for speed and 'getting the deal done' seems to have risen to the top of the M&A agenda. Half of the companies surveyed said that the imperative to close deals quickly and with certainty was more important than waiting longer secure a higher price.

HP: The 15 year road to divorce

As discussed above, there are many reasons that a merger might not survive in the medium to long-term and by no means all of them signify that the acquisition was flawed. However, some companies are forced into disposals, demergers or spin-offs because they have a poor track record of buying and integrating businesses

One such company is HP. This once-great corporate's merger with Compaq was probably ill-advised while the takeover of UK-listed Autonomy was simply a disaster, as discussed in earlier sections.

In mid-2014 under pressure from its investors, the company announced that it would split into two publicly traded units: Hewlett Packard Enterprise and HP Inc., the former a more forward-looking business selling servers, software, networking and associated services and the latter the more traditional part of the business selling printers and PCs – thus including a large portion of what was Compaq. In November 2015, that split took effect.

There has been much debate about exactly where it went wrong for HP, but the Compaq purchase in 2001 seems to have begun the decline. The company itself was built on acquisitions, with the first taking place back in 1958 but accelerating in the 1990's and into the new millennium: in the period from 1989 to 2015, 125 acquisitions were made.

In the wake of the Compaq acquisition, HP embarked on a series of very large deals, each one seemingly worse than the last, culminating in the Autonomy debacle. Before HP was forced to write off that $8.8 billion of the $11.1 billion purchase price of Autonomy in 2011, it took an $8 billion write-down on its 2008 acquisition of EDS, the computer services business for which it paid $13.9 billion. Before Leo Apotheker, the CEO in charge during the Autonomy deal, was fired, he had proposed a plan to sell off HP's PC division, but it was abandoned by his successor Meg Whitman when she took charge. Whitman finally threw in the towel and backed the demerger in 2014. In 2015, sixteen years after the initial merger, HP Compaq formally split into two separate companies.

For all its difficulties, HP did take time to execute carefully an incredibly complicated demerger. Formal paperwork for the deal was filed in 2014, 18 months before the split, and the company began to operate as two businesses for internal purposes six months before the demerger was formalised.

The financial terms of the split also seemed sensible with the supposedly higher-growth Hewlett Packard Enterprise shouldering the costs of its own restructuring, rather than heaping losses on the legacy printer and PC business. In a move that will at least provide board continuity, Whitman was made CEO of Hewlett Packard Enterprise as well as chairwoman of HP Inc.

The spin-off dumping ground

Spin-offs can be an effective way of separating assets with fundamentally different characteristics, allowing the stock market to price the growth prospects of each segment more accurately. However, the financial and strategic rationale of spin-offs is not always so clear; some deals use the spun-off company as a dumping ground for either liabilities or less attractive assets that cannot be sold.

One such example is the 2013 split of Rupert-Murdoch's US-listed media giant News Corporation into its traditional print newspaper arm, which includes *The Wall Street Journal* and *The Times*, and 21st Century Fox, which owns the eponymous film studio, Fox News and a stake in BSkyB, the European broadcaster. The decision to split was made in the wake of the phone hacking scandal

which saw Murdoch close his UK-based newspaper *The News of the World*, but failed to avoid a wider shareholder revolt from investors with no interest in the other print media assets.

In this case, however, Murdoch left his print empire with a around $2.6 billion in cash with no debt, plus some legacy Australian TV assets which were still profitable and thus able to offset the ongoing losses at the newspapers. The split seems to have worked: the share price of 21st Century Fox has soared, while News Corp has fluctuated, but not fallen more than 25 per cent below the issue price – in today's world of on-line news delivery, that's a victory for an "old media" company.

A less edifying example was Viacom's flotation of its video rental chain Blockbuster. Unable to sell the company, Viacom spun it off in 1999 but just before doing so arranged for it to borrow $1 billion to cover a final special dividend of $905 million. Blockbuster was soon overtaken by massive changes in the media industry as the internet developed. After many years of struggling, the business filed for bankruptcy in 2010.

Another option to offload undesired assets is to pay someone else to take it off your hands. This was the route followed by UK-listed Anglo-French retailer Kesa when disposing of its troubled electrical retail arm, Comet. To sweeten the sale, Kesa left Comet with a £50 million dowry, as well as retaining responsibility for its employee pension liabilities. The business was sold to OpCapita, the investment vehicle of US financier Henry Jackson for £2. Yet less than two years later it collapsed, owing the UK government nearly £70 million in tax and statutory redundancy payments. OpCapita banked £100 million from the deal, leaving the government fuming, but ultimately unwilling to take legal action.

Getting divestment decisions right - the basics:

In making and executing decisions to invest and divest, companies should follow four basic rules:

1) Ensure you have the right information to manage a portfolio successfully

Frequent portfolio reviews enable companies to react quickly to changes in the market and reallocate capital accordingly; by doing this, non-core businesses can also be sold at the optimal time. However 58 per cent of executives of the companies surveyed by EY in 2015 acknowledged that they do not go through this process frequently enough. Best practice would suggest that a review should be done every six months, if not more frequently. This applies to large companies and small alike, although the larger, older companies are more likely to have amassed a greater number of now non-core businesses than a newer one. But that doesn't mean that every company of any size shouldn't continuously assess what could be spun off. They should.

In order to complete such a review, companies must understand the way costs are allocated to different business units, use the right industry benchmarks and develop tailored analytical tools to make sense of any big data that's available. As part of this process, medium and large corporates should also improve communication between the board and the in-house or external M&A team and their shareholders

2) Learn value creation lessons from private equity

Private equity firms can be masters of value creation at sale. The key to this is planning: prepare for a sale early. If the company has 12 to 24 months to prepare, the business being divested should be treated internally as a standalone entity as soon as possible. There might also be time to be creative, for instance, by expanding to different geographies or markets using a joint venture agreement, although here beware of the pitfalls discussed earlier. Extracting working capital, which buyers tend not to pay more for, is an easy-to-achieve option. If the company has less than 12 months, at least establish a clear story of how this asset might be attractive to prospective buyers.

3) Improve divestment execution

Again, planning is key here, with EY's study finding that high-performing companies are 50 per cent more likely to start to have begun their sale preparation at a much earlier stage than low-performers, who start late and therefore have to take short cuts.

The key to doing this lies in putting in place the right governance structure for a sale, probably with an executive steering committee that can make quick decisions. The specific asset(s) for sale should also be rigorously defined, but this specification should allow for different sales options for potential buyers who may not want all parts of the business.

IT can often be the most complex area of any organisation or division to be sold, so this issue will usually require the longest lead time. The tax structure of any divestment should also be optimised (yet kept flexible as the final tax structure it is dependent on the buyer). Finally, the sale should be analysed from the perspective of different types of buyers both trade and private equity in order to create the best possible sales pitch.

4) Strike the right balance between speed and value

The ideal solution is to prepare the sale over a long period, but that assumes flexibility on timing that many companies don't have. There may be significant pressures on timing because deal uncertainty could damage an asset, the window of opportunity to sell may be narrow or the capital may be needed urgently to invest elsewhere.

However, to maximise value, a seller should make sure to invest – and not underinvest as will be the temptation - during the sale preparation period in to create additional value for the asset, find additional buyers, and try to put yourself in the buyers' position to understand better what 'story' will sell most strongly, including the potential synergies for each type of buyer.

Mergermarket Group: From start up to global player

The business life cycle of financial news and data provider Mergermarket Group since 2000 shows that there are times when it is beneficial to be part of a large corporate and times when it is better to be a standalone company.

Mergermarket had a modest start at an inauspicious time. Born in 2000 in the wake of the dotcom bust, it was the brainchild of Caspar Hobbs, a former army major and Charlie Welsh, a journalist at Financial News, a London-based publication.

At the core of the business was its subscription revenue model, a system that the world's biggest newspapers are still struggling to push through a decade and half later. The service mixed timely and proprietary intelligence from and about expected and completed corporate events (M&A deals, IPOs and other capital raising activities) with good data from external sources. It really found its feet with the almost universal adaptation amongst bankers and other advisors of the BlackBerry, which allowed them to receive instant intelligence direct to their mobile phone wherever they were.

Fast forward to 2005 and Mergermarket's revenues were £18 million, sufficient to get the early stage investors an exit. The business was sold to Pearson, the London-listed media giant and owner of the Financial Times for £101 million.

At the time Pearson was headed by Dame Marjorie Scardino, who famously promised Pearson would sell its crown jewel asset, Financial Times, only "over her dead body". Chief executive of the Financial Times Group subsidiary at the time was Rona Fairhead, who saw in Mergermarket a business that had already mastered the digital environment at a time when the FT's online service *FT.com* was relatively young, free to use and loss-making.

Hamilton Matthews, CEO of Mergermarket Group, had been brought in in 2001 from the capital markets division of Thomson Financial to drive the commercial side of the operation; by 2009 he was running the business. “We didn’t have to go through the digital integration legacy issues, which was why the FT wanted us so much. When newspaper sponsorship started to fall, it suddenly became a very hard model to make work,” says Matthews.

Explaining the rationale for the deal at the time, Fairhead said Mergermarket: would add “proprietary content, a premium customer base, reliable growth from new revenue sources and attractive financial characteristics” to her group. Fairhead also highlighted opportunities to jointly develop new products, increase advertising and sponsorship revenues and share IT with other parts of the FT Group.

As we will see, however, the FT Group only ever took advantage of one of those potential factors - the attractive financial characteristics of Mergermarket, which enabled Pearson to reap more than three times its purchase price when it sold the business seven years later.

The terms of the acquisition included a two year earn-out that prevented any meaningful integration during that period, meaning Mergermarket was left alone to concentrate on its globalisation strategy. But even after that, the businesses were kept almost completely separate with no integration of customers and IT and very few joint product launches. Notably, the FT journalists covering the capital markets even used and quoted data from competitor (Dealogic) rather than their sister in-house source, Mergermarket.

Nevertheless, for Mergermarket the tie-up was helpful, Matthews claimed: “It was great for us to join such a credible media organisation and it made it much easier for the editorial team to be able to get leads and sources once we were part of the FT”.

He added, “But any form of integration cannot be forced because it won’t work and the argument was that the brands and the culture were very different, both on the sales and on the editorial side. But some of it was madness such as people who wanted to join us from the FT - or vice versa - having to interview in the open market.”

Later, even though Fairhead tried to get the five divisional CEOs of the FT Group to collaborate on smaller projects, there was still no real integration. When the financial crisis hit in 2008, the group moved into defensive mode and the individual CEOs prioritised their own businesses. As time went on, Pearson shifted even further towards its focus on the education sector and, when Dame Scardino was replaced as chief executive by John Fallon, the group made clear that its future focus would be 100 per cent on that area.

As a result, Mergermarket was put on the block in 2013. The sale to the private equity firm BC Partners for £382 million was used to fund the initial losses incurred on setting up *FT.com* and in the long run helped turned that business to a profitable venture with over 500,000 paying subscribers in 2015.

Subsequently, Pearson also sold both the Financial Times Group and their investment in The Economist Group (publisher of The Economist), long regarded as the jewels in its corporate crown.

Meanwhile, Mergermarket was finding that life was very different under BC Partners.

“We loved being part of Pearson for seven years,” said Matthews. “It was the right home for us, but we were crying out for investment. We are an innovative business - we wanted to be able to make acquisitions, launch new products and do it quickly”.

BC Partners, who already used Mergermarket's products, knew the business very well by the time they bought it. The first thing they did was help Matthews to transform Mergermarket's technology platform, bringing in a new chief technical officer they had worked with in another portfolio company and building a completely new 45-person IT team.

The plan – an IT consolidation initiative together with a number of focused acquisitions - was to drive pre-tax profits to levels double to where they were when BC Partners purchased it. By 2015, Mergermarket had grown to include over 1000 staff, including 500 editors, researchers and analysts, each expert in that niche financial market.

The Investor's View

At 30 years old, BC Partners is one of the most venerable private equity houses, managing over €12 billion assets globally. Where some rivals have eschewed the media sector, particularly publishing, BC has been prepared to take a punt on the right business, also buying Berlin-based Springer, the science and business publisher in 2013.

So when Pearson put Mergermarket up for auction, BC was at the front of the queue. BC Partners' Managing Partner Nikos Stathopoulos explained: "A combination of reasons attracted us. First of all, it is the market leader in a highly attractive and fast-growing segment of the market, it is diversified and revenue generative and the space is highly fragmented so we could see opportunities for both organic growth and acquisitions."

With all the usual private equity investment drivers ticked, BC drilled down during their due diligence process and found strong management, a subscription business model that allows Mergermarket to get paid in advance for the year and renewal rates of 90 per cent.

Did BC have any doubts about taking on journalists, a section of the populace most in private equity go out of their way to avoid?

"As an investor you always have some concern when the assets go home every night. What gave us comfort here is that you have a market-leader who we feel historically has managed to recruit and retain its staff because of a combination of the company's growth prospects, pay or conditions.

"We also looked at Mergermarket's pre-publication verification process and its accuracy and were highly comforted by the company's very low record of editorial complaints," says Stathopoulos. The breadth and depth of Mergermarket's talent pool across editorial, research and data analysis was seen by BC to be a competitive advantage and a significant barrier to entry as having such scale and reach is hard to replicate, but also means no one individual is indispensable to the business.

After taking over, BC took a four-pronged approach to growing Mergermarket which included having no significant losses of personnel, investing cash in IT infrastructure, funding acquisitions for Mergermarket to expand its products and services and finally, and perhaps most importantly for what was already a successful people business, leaving Mergermarket's employee culture and environment virtually intact.

On this final point, the Mergermarket journalists have even been allowed to write totally independently about investments related to BC Partners. In line with its private equity mantra of incentivising performance by linking it to pay, BC realigned the packages of sales staff. It also introduced a management equity scheme that includes not just the executive board of the company, but also the second tier of management so all the key executives have private equity's desired "skin in the game". The scheme was believed to be one of the broadest in place at a private equity-owned business.

For many financial buyers, corporate spin-offs are low hanging fruit. "We feel that spin-offs have been broadly successful investments mainly when they involve small divisions of large corporates

where they tend to be under-invested and under focused," says Stathopoulos, noting that under Pearson in its last full financial year (2012), Mergermarket's turnover of $100 million equated to only around 1.5 per cent of the parent group's revenue so was clearly non-core. "Once they become standalone, the management is better motivated and focused to grow and the owners to invest. This is especially true with a fast-growing business like Mergermarket."

When the time is right, Mergermarket will be sold, either through a trade sale, to another private equity investor, or listed via an IPO. If it is the former, will Mergermarket find a more permanent home inside a big corporate the second time around? The answer, thinks Stathopoulos, may be "yes". A more mature business, he feels, might benefit from adding a fast-growing diversified global business.. It would offer synergies, while not needing the same level of hands-on attention and investment that had been required during Mergermarket's high-growth phase in the period immediately following BC's purchase in 2013.

This case also demonstrates what can be done in M&A by financial sponsor firms, such as those doing private equity, whose business it is to buy and sell companies. This is directly related to the principal focus of this section - amicable corporate divorces – because selling all their acquisitions is the goal of these firms.

These expert acquirers have shifted their business models over the years, and clearly recognise the necessity to focus on the Big Three issues that have been discussed throughout this book: planning, communication and people. Indeed, the global co-head of private equity at White & Case, Ian Bagshaw, explained it to us as follows:

> Over leverage has historically been the key cause of PE [private equity] deal failure with the focus on servicing debt and ultimately managing creditors. But now it's a case of "back to the future" as the key challenge is ensuring that the executive team is right and that they are hitting the plan, which can often involve a series of bolt on acquisitions through the investment period. As the private equity industry has developed and moved away from financial engineered returns to focus again on growth as a primary driver of buyout returns, the need for a team to run the business and execute synergy extraction through an executed build out has never been higher.
>
> PE deal doing is ultimately about backing the right people and therefore the biggest issue is whether you have them in the team.

In summary, as the Mergermarket deal demonstrates, breaking up is not necessarily a bad thing to do. Indeed, with the right attention, investment and planning, once unloved assets can be polished up into real gems. However, for buyers and sellers alike, the foundation is in the planning and making absolutely sure that a sale or an acquisition fits with the company's strategy. And if staff or the incumbent management are crucial to that business, that includes keeping them onside too.

A Most Amicable Divorce: THE DOs AND DON'Ts

- **DO keep it friendly. Make sure management remains on good terms during a split; you might get less money for a sale without them.**
- **DO remember that, if you are a buyer, corporate carve-outs have a track record of being good bargains**
- **DO take a page on value creation lessons from private equity; go for a high-growth business if the acquisition is central to your strategy, at least you will be able to sell it on for a profit later, if necessary**

- **DON’T become complacent in your approach to your business portfolio. Evaluate market conditions for selling assets or subsidiaries continually, and formally at least semiannually**

- **DO expedite the sale process: the market hates uncertainty**

- **DO act before an activist investor joins your shareholder register and forces you to take action**

- **DON’T procrastinate your sales preparation process: start 12-18 months prior to a sale if possible, focusing both on operational and financial housecleaning but also on crystalizing the value proposition for key buyers**

0.11. Hunting the Corporate Yeti

M&A is here to stay.

As the global economy continues to grow and businesses push to expand and integrate across national boundaries, the long-term trend is for more and more mergers, whatever the cyclical hiccups along the way. This is true whether the companies managing are large or small, in high tech or traditional industries.

Against this backdrop it is hard to underestimate the importance of M&A to the world economy and to global prosperity. As we discuss in the introduction to this book, numerous studies have found that in the longer-term mergers and acquisitions actually destroy value in more than half of deals even if the overall contribution of those deals both to companies and the economy overall is positive.

Many of those studies have also found that successful buyers *can* add huge financial value for their shareholders in both the short and long term if the deals are done well. But too many failed deals still occur – a surprising fact given that the reasons for failure, as discussed throughout this book, are very often very public and are clearly there for other deal practitioners to see.

The M&A equation should be simple: well-run and well-managed companies can execute good acquisition strategies with an overall financial benefit for their shareholders and the wider economy.

Disappointingly, although more and more acquisitions are being made, there is little evidence that companies since the turn of the millennium are getting any better at them. Yes, the level of deal success is much better than during the 1980's and 1990's when failure rates were as high as 70-80 percent according to some studies. But the improvement to a 50/50 success rate in the early 2000's has not improved since. And that still is no better than a flip of the coin.

We are currently operating in a different paradigm. During the recent merger booms, the consequences of bad decision-making were magnified when the markets turned. Readers need only look at some of the pre-financial crisis deals outlined in this book to be concerned that history will repeat itself if lessons are not learned. Bad deals don't necessarily manifest themselves as such until the good times stop. Thus we expect that some of the deals being done now – that look today to be excellent – will turn into failures, too.

We have set out a simple, easy to follow set of rules that will help companies to avoid the obvious mistakes that sink so many deals. We hope in doing so to champion a more rigorous and thoughtful approach to M&A that will benefit the wider economy at the macro level. If this is too ambitious a goal, we hope at least that these ideas will help readers to make their company, at the micro level, to be one of the winners at merging with and acquiring other companies.

Throughout this book we have tried to distill our thoughts to useable, bite-sized practical nuggets. In one last attempt to concentrate our mantra, we end here with our final five **recommendations:**

DON'T treat M&A as a strategy – it is only a tactic to achieving the company's long-term goals.

M&A is not the only method by which you can achieve long-term goals. Consider the others first, but once you have plumped for M&A you will need to dedicate significant time, money and management time to executing the deal.

DO remember that M&A deal-making is an art, not a science.

At the same time, do remember that M&A deals involve emotions and pressure for the CEO and the Board to perform, and this percolates throughout the organisation once the deal is announced. Those executives who see the main chance *and* are agile enough to reach it, who can listen *and* negotiate and who are focused but still flexible will carry the day. They will also realise that sometimes 'carrying the day' will mean walking away from a broken deal.

DON'T focus only on 'doing the right deal' as 'doing the deal right' is equally important.

This is perhaps our single most important lesson. Doing the groundwork of good target selection, extensive due diligence and careful pricing will provide you with the right foundations for this. Remember it is only at this post-closing stage that you will reap the benefits of all your hard work; post-deal implementation attracts less attention and scrutiny than the pre-deal period but is where the real value can be added or destroyed irrespective of the rationale of the deal. Having the perfect business and synergy case but with flawed execution will not yield success.

DON'T make the same mistakes twice: make sure to do a post-audit review of each deal whether successful or not, so that you can learn for the next time

Even legendary serial dealmakers such as GE in the 1980s and 1990s and Cisco Systems in the first decade of this millennium get it wrong sometimes. The difference is that they learn from their mistakes and when they do it again, they have a better chance to do it right. Having a thorough and objective understanding of what went well or badly at each stage of the deal is vital in order to avoid falling into the same pitfalls next time. Creating a corporate knowledge base which is actively applied by and institutionalised with the company as a whole (versus being resident only in the heads of a few executives) is a critical component of whether deal-making will be a success of failure next time. If things do go wrong, cut your losses and remember our guidelines for a good divorce.

And finally…

DON'T forget The Three Big Mistakes of Deal-Making: planning, communication and people.

As we have shown throughout this book, companies who make mistakes in these areas fail. The soft stuff is the hard stuff. You might be lucky and just about get away with one or two, but do any more deals than that and, like HP in many of its acquisitions but especially its disastrous purchase of Autonomy, you will fail.

And with that, we would like to leave readers with a challenge. As authors and practitioners have been unable to a find a deal where more than one of the Big Three Mistakes were made and where the acquirers subsequently managed to bring it back from the brink of disaster. The reason we wrote this book is because we believe the best way to learn is from mistakes - our own and those of others. So we invite you to hunt with us for the “M&A Yeti” - the worst deal to come back from the brink. Readers are asked to submit ideas to our microsite blog: www.whydealsfail.org

1. Assessing market attractiveness for mergers and acquisitions: The M&A Attractiveness Index Score (MAAIS)

Naaguesh Appadu, Anna Faelten, Scott Moeller and Valeriya Vitkova

Abstract

This paper presents a new scoring methodology designed to measure a country's capability to attract and sustain business investment activity in the forms of cross-border inflow and domestic mergers and acquisitions (M&A). We compute a theoretically grounded index of attractiveness for M&A purposes based on groups of country development factors which have been identified as key drivers of corporate investment activity in economics, finance and management literature. By using the Index, which has been successfully tested against country-level M&A activity in a time series analysis, we show that the drivers of M&A activity differ significantly at different stages of country maturity. Specifically, for mature countries, the quality of their regulatory systems, political stability, socio-economic environment and the sophistication of their physical infrastructure as well as the availability of sizeable assets all determine differences in country-level M&A volume and value activity. For countries at the transitional stage, it is instead their economic and financial health, socio-economic environment, technological developments and the quality of their infrastructure and the availability of sizeable assets which drive M&A activity. We also prove the predictability power of the Index, by a set of Granger causality tests, showing how country-level development drives future M&A activity but also how, to some extent, the inverse relationship is also true, i.e. that M&A activity can contribute to country development.

1.1. Introduction

Despite the ongoing negative influence of the global economic and financial crisis of 2008-2009, as well as the continuing sovereign debt crises, global foreign direct investment (FDI) inflows grew by 16% in 2011 (Global Investment Report, 2012), exceeding their 2005-2007 pre-crisis level for the first time. The so-called developing markets around the world are making headlines with faster economic recovery and stronger consumer demand, at least as compared to the more developed markets, as well as large-scale investment liberalisation and promotion. For companies wishing to operate globally, it is no longer a question of whether to invest in the developing markets, but rather a matter of in which of these alternative markets they should focus their investments and future growth.

There are four distinct, albeit interrelated, themes in economics and finance literature that are identified as making a country attractive for M&A activity. First is the voluminous area of research which explores the drivers of FDI in general (see, e.g., Delios and Henisz, 2003; Peng, Wang and Jiang, 2008; Busse and Hefeker, 2007; and Kolstad and Villanger, 2008 for

analyses of the regulatory and political group of FDI drivers, and Buch and De Long, 2001; Fontagne and Mayer, 2005; as well as Rugman and Li, 2007 for analyses of the economic and financial group of FDI drivers). Second is the emerging literature which focuses on the drivers of FDI in developing, as opposed to developed, economies and the need to distinguish explicitly between different stages of country development when analysing the drivers of FDI (see, e.g., Heshmati, 2003; and Duarte and Restuccia, 2007).1 Third are the studies which call for the need to analyse M&A as a separate process instead of considering it under the more general FDI umbrella (see, e.g., Ryan et al., 2009; Nocke and Yeape, 2007; as well as Haller, 2008). Finally, the extensive research on the impact on finance of the rule of law, triggered by the seminal work of La Porta et al. (1998), which proposes theoretical arguments and empirical regularities on how differences in legal investor protection between countries determine investor confidence and, ultimately, market development. One of the outputs of the analysis of La Porta et al. (1998) was the development of a now well-known index which measures the quality of shareholder protection at the country level, namely the anti-director rights index. The wealth of research on cross-country variation in governance structures has linked, on one hand, shareholder legal protection to the development of stock markets around the world (La Porta et al., 1997), types of law (common/civil; La Porta et al., 1998), efficiency of capital allocation (Wurgler, 2000), firm valuation (La Porta et al., 2002), listing in the US (Reese and Weisbach, 2002), earnings management (Leuz et al., 2003), cash-holdings (Dittmar et al., 2003) and expropriation by corporate insiders (Djankov et al., 2008) on the other. La Porta et al.'s (1998) index has since been criticised (Cools, 2005), revisited (Djankov et al., 2008) and given suggested alterations in subsequent literature (Spamann, 2010). Djankov et al. (2007) construct a legal index which focuses on creditor rights as opposed to shareholder rights.

Following on from this research into the identification of the factors which influence M&A activity at the country level, this paper thus develops a multi-factor index incorporating these factors, designed to measure a country's attractiveness for M&A purposes (the M&A Attractiveness Index Score [MAAIS]), based on country development factors categorised into the following five groups: 1) Regulatory and political factors (e.g., rule of law (DeLong et al., 2001 and Rossi and Volpin, 2004) and corruption of officials (Yartey, 2008)); 2) Economic and financial factors (e.g., GDP growth (Berthelemy and Demurger, 2000 and Liu et al., 2009), stock market capitalisation and access to financing (Yartey, 2008 and Saborowski, 2009)); 3) Technological factors (e.g., innovation (Porter, 1993; Tsai, 1994; and Chung and Alcacer, 2002)); 4) Socio-economic factors, such as people and demographics; and 5) Infrastructure and availability of asset factors, such as the level of physical infrastructure development, e.g. roads and railways, and the number of sizeable corporate assets (see, e.g., Wheeler and Mody, 1992; Loree and Guisinger, 1995; Asiedu, 2002; Mateev, 2009; and Anyanwu, 2012). Based on a percentile classification methodology, each country receives an Index score as an average from these factors which ranges between 100% and 1%, with 100% being the best achievable score in terms of M&A attractiveness.

[1] Specifically, Pan (2003) argues that FDI patterns in developed countries should not be generalised to incorporate developing and transitional economies. Furthermore, according to Blonigen and Wang (2005), the factors which affect FDI location differ systematically between developed and developing countries. Phylatkis and Xia (2006) demonstrate that country-level factors are more important than industry factors when analysing the differences in performance of firms involved in FDI.

We adopt the country development classifications used by the United Nations Statistical Office [UNSO] that describe a mature stage (reached by all developed countries), a transitional stage (reached by all developing countries) and an emerging stage (reached by less developed countries). The average Index score for mature markets is found to be 70%, whereas the transitional average score is 50% and the emerging average score 32%. Interestingly, the results reveal that although the quality of a country's regulatory system and its political stability are found to be prerequisites for reaching full market maturity, they are not significant drivers of M&A activity for countries classified as transitional and emerging. At the transitional stage of development, a country's technological, economic and financial, and socio-economic factors, as well as the quality of its infrastructure and assets, all show a significant relationship with M&A activity. The results also show that the model is a poor fit for M&A activity in emerging economies, suggesting that dealmaking activity in these markets has a very different set of drivers.2 Finally, we find the Index to be able to forecast country-level M&A activity with statistical significance using a set of Granger causality tests. The relationship is also significant in the opposite direction, albeit not as strong or with as many lags, suggesting that M&A activity in itself also contributes to country development.

Of the two main components of FDI in terms of both volume and value, namely greenfield investment and cross-border M&A, it appears to be the latter which has become the key driver of international business activity over the last three years. In 2011, cross-border M&A increased by 53% in terms of deal value while greenfield investment remained relatively flat (Global Investment Report, 2012). Along with this major shift in the form of global investment activity, the proportion of developing markets participating in M&A has risen substantially from approximately 10% of total global activity in 1998 to almost 40% in 2011, according to the SDC Platinum database. In light of this increasing importance of developing markets to the global economic and financial environment in general and to the M&A environment in particular, this paper develops a universal and updatable scoring methodology for determining a country's attractiveness for M&A activity.

Section 1.2 discusses the variables included in the Index. Section 1.3 describes the sample as well as the methodology used in the study. Chapter 1.4 discusses the empirical results and Chapter 1.5 concludes.

1.2. The MAAIS variables

MAAIS is a scoring methodology designed to evaluate a country's capacity to attract and sustain M&A activity. Hence, it is designed to provide an overview of how developed a country is for current and future M&A activity – arguably an important barometer of the health and sustainability of the national business environment, irrespective of the nationality of the acquirer firm. For the same reason, we include factors measuring the ease and attractiveness for any buyer – domestic or cross-border – of making an acquisition and test their fit and predictive powers on the same set of data. The Index is based on the following country development factor groups, all of which have been identified as important for these purposes in the relevant literature or by market practitioners: regulatory and political, financial and economic, technological factors, socio-economic and factors relating to the development of

[2] One suggestion here is the abundance of natural resources, which intuitively drives a significant proportion of investment – local or inward from other countries – in these types of countries (e.g. in Africa).

physical infrastructure and the availability of assets. Since we aim to provide an updatable scoring methodology and database, it is important that data sources and updates are available for all countries when changes occur as these countries develop. Hence, for each factor group, several widely recognised surveys, reports or databases (sourced from international institutional bodies, such as the International Monetary Fund (IMF)) were identified for inclusion.

Table 1.2-A: Sub-factor variables descriptions and sources

Panel A: Regulatory and Political [RegPol] factor group

Rule of Law	The rule of law concerns the consistency of the application of the law. The data for this comes from the World Bank's *Governance Matters* report. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Completion Formalities	Completion formalities concerns the level of administration involved in setting up a business, measured in administrative time (days). The data for this comes from *Doing Business* by the World Bank. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Registering Property	Registering property concerns the procedures necessary for a business to purchase a property from another business, measured in administrative time (days). The data for this comes from *Doing Business* by the World Bank. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Paying Taxes	Paying taxes concerns the level of taxes and the related administration involved in paying taxes, measured in administrative time (days). The data for this comes from *Doing Business* by the World Bank. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Trading Across Borders	Trading across borders concerns the procedural requirements for exporting and importing, measured in administrative time (days). The data for this comes from *Doing Business* by the World Bank. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Enforcing Contracts	Enforcing contracts concerns the efficiency of the judicial system in resolving commercial disputes, measured in administrative time (days). The data for this comes from *Doing Business* by the World Bank. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Political Stability	Political stability measures perceptions of the likelihood that the government will be destabilised. The data for this comes from the World Bank's *Governance Matters* report. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Sovereign Debt Rating	Sovereign debt rating is an overall assessment of fiscal policies. The data for this comes from Fitch's *Complete Sovereign Rating History*. The sub-factor percentages were developed by percentile classification based on the full country dataset.
Control of Corruption	Control of corruption measures perceptions of the extent to which public power is exercised for private gain. The data for this comes from the World Bank's *Governance Matters* report. The sub-factor percentage was developed by percentile classification based on the full country dataset.

Panel B: Economic and Financial [EconFin] factor group

GDP Size	GDP size measures the economic size of the market. GDP size is measured as the average estimated GDP size for the next five years, i.e. a rolling average. The data for this comes from the International Monetary Fund's World Economic Outlook Database. The sub-factor percentage was developed by percentile classification based on the full country dataset.
GDP Growth	GDP growth measures the economic growth of the market. GDP growth is measured as the estimated compounded average growth rate for the next five years, i.e. a rolling average. The data for this comes from the International Monetary Fund's World Economic Outlook Database. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Inflation	Inflation concerns economic growth and monetary policy. Inflation is measured as the average from 2012 to 2016 (estimated). The data for this comes from the International Monetary Fund's World Economic Outlook Database. The sub-factor percentage was developed by percentile classification based on the full country dataset.

Development of Equity Market	Development of equity market concerns access to equity financing through capital markets. It is measured as the stock market capitalisation as a percentage of GDP. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Availability of Domestic Banking Credit	Availability of domestic banking credit concerns access to financing and credit from domestic banks. It is measured as the private credit provided as a percentage of GDP. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.

Panel C: Technological [Tech] factor group

High-Technology Exports	High-technology exports concerns the volume and quality of domestically produced high technology. It is measured as the level of high-technology exports as a percentage of all manufacturing exports. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Innovation	Innovation concerns the level of innovation and entrepreneurship, and is measured by the number of patents granted per country of origin. The data for this comes from the *World Patent Report Statistical Review* by the World Intellectual Property Organization. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Internet Users	Internet users measures the level of technological skills of the population. It is measured as the number of internet users per 100 people. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.

Panel D: Socio-economic [Socecon] factor group

Population Size	Population size concerns the total population of the country. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Population Demographics	Population demographics is the percentage of the population aged between 15 and 64 out of the total population. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.

Panel E: Infrastructure and Assets [InfrAsst] factor group

Sizeable Assets	Assets concern the number of registered firms (>$1m assets) in each country. The data for this comes from the 'Orbis' (Bureau van Dijk) database. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Ports	Port capacity is measured by the amount of container port traffic (twenty foot equivalent unit). The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Railway Lines	Railway infrastructure is measured as the total length of railway lines (km). The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.
Paved Roads	Road infrastructure is measured as the percentage of paved roads in relation to the total number of roads. The data for this comes from the World Bank's *World Development Indicators*. The sub-factor percentage was developed by percentile classification based on the full country dataset.

1.2.1. Regulatory and political factor group

The extensive research on the effects of the rule of law is both interesting and relevant when considering the area of corporate finance that is M&A. Rossi and Volpin (2004) test the relationship between shareholder/creditor rights and cross-country M&A. Their findings show that M&A activity is more prevalent in countries with better accounting standards and stronger

shareholder protection, with cross-border transactions playing a critical governance role by improving the degree of investor protection. In addition, their study shows that in cross-border deals, targets are typically from countries with poorer investor protection relative to those of acquirers, suggesting that cross-border transactions can play a disciplinary role by improving the degree of investor protection within target firms. Kose et al. (2010) further extend the research in this area by examining announcement returns in cross-border M&A by US acquirers and finding that returns decrease with the level of creditor protection and increase with the quality of accounting standards. However, for target countries with strong shareholder protection, acquirers experience negative share price reaction around the time of deal announcement when the target is public and positive share price reaction when the target is private.

Whilst the aforementioned research has contributed greatly by establishing a link between certain aspects of a country's legal environment and their effect on M&A activity, there are other factors that may influence a country's ability to attract and sustain M&A activity which should be considered. We suggest that there are a number of other variables in this category which matter as they have practical implications which could hinder not only the transaction process but also continued business operations in the country. The complexity of a country's tax system and the time and costs related to registering new property are two examples. In addition, DeLong et al. (2001) find that mergers tend to be less frequent if information costs are high, which supports the hypothesis that a more transparent business environment fosters M&A activity and therefore suggests that the Index should include measures such as control of corruption.

We summarise the variables in the Regulatory and Political factor group in Table 1.2-A (Panel A), which include: Rule of Law; Completing Formalities; Registering Property; Paying Taxes; Trading Across Borders; Enforcing Contracts; Political Stability; Sovereign Debt Rating; and Control of Corruption.

1.2.2. Economic and financial factor group

Guerin and Manzocchi (2009) argue that democracy has a positive effect on the amount and probability of FDI flowing from developed to developing countries. Berthelemy and Demurger (2000) stress the importance of the potential for future growth in foreign investment in China. They find that FDI plays a fundamental role in China's economic growth. Liu et al. (2009) find similar results while observing a two-way causal relationship between trade, inward FDI and inward M&A, and economic growth for most economies. It is evident that the presence of economic growth and business trade is a necessary condition for an M&A market to develop, which supports the inclusion of economic factors in the Index.

The development of domestic capital markets is another key driver of M&A activity since investment requires capital and because it is more cost-effective to source capital from the local market. Yartey (2008) argues that macroeconomic factors, such as income level, gross domestic investment, banking sector development, private capital flows and stock market liquidity, are important determinants of stock market development in emerging market countries. His results also show that political risk, law and order, and bureaucratic efficiency are all important factors in the development of stock markets because they enhance the viability of external finance. They also suggest that the reduction of political risk can be an important factor in the development of stock markets in emerging economies. Saborowski

(2009) shows evidence that the exchange rate appreciation effect of FDI inflows is indeed attenuated when financial and capital markets are larger and more active. The main implication of these results is that one of the main dangers associated with large capital inflows in emerging markets – the destabilisation of macroeconomic management (due to a sizeable appreciation of the real exchange rate) – can be partly mitigated by developing a deep local financial sector. This is a key idea in this study since it highlights the importance of developed capital markets and a stable financial system to the ability to sustain M&A activity, thus supporting the inclusion of financial factors in the dataset.

We summarise the variables in the Economic and Financial factor group in Table 1.2-A (Panel B), which include: GDP Size; GDP Growth; Inflation; Development of Equity Market; and Availability of Domestic Banking Credit.

1.2.3. Technological and Socio-economic factor groups

Following Porter (1993), Tsai (1994) and Chung and Alcacer (2002), the issue of a country's social development as well as its level of technical innovation and entrepreneurship are shown to be of high importance in the formation of a sustainable M&A market, arguing that if unemployment is high and the workforce unskilled, there will be little scope for the development of businesses and low interest in growth in the country. Similarly, if no appetite or support for R&D or technological development exists, the country will stagnate internally and be unable to sustain M&A activity. All of these factors provide a rationale for the inclusion of technological and socio-cultural factors in the database, although our analysis has led to the expansion of these two categories beyond the level suggested by existing literature.

We summarise the variables in the Technological factor group in Table 1.2-A (Panel C), which include: High-Technology Exports; Innovation; and Internet Users, and the variables in the Socio-economic factor group in Table 1.2-A (Panel D), which include: Population Size and Population Demographics.

1.2.4. Infrastructure and assets factor group

Finally, studies have also demonstrated that the size of a country's market and, therefore, the availability of assets are an imperative driver of FDI flows (see, e.g., Mateev, 2009; and Anyanwu, 2012). This is particularly important for country-level M&A activity as many countries have concentrated ownership across industries for historical, cultural or political reasons, which hampers the process of reallocating inefficient capital. Also, assets, i.e. target firms in this context, need to be 'sizeable' in order to be attractive as the potential return on investment needs to exceed the costs associated with the acquisition. In addition, a number of studies demonstrate both theoretically and empirically that the quality of transportation infrastructure can affect FDI flow, i.e. higher quality of roads, ports, runways, etc. is positively and significantly related to FDI (see, e.g., Wheeler and Mody, 1992; Loree and Guisinger, 1995; and Asiedu, 2002).

We summarise the variables in the Infrastructure and Assets factor group in Table 1.2-A (Panel E), which include: Sizeable Assets; Ports; Railway Lines; and Paved Roads.

1.3. Data and Methodology

As demonstrated in Table 1.2-A, a total of 23 country development variables populate the five factor groups,3 with the regulatory and political group consisting of nine factors, the economic and financial group including five, the technological group three, the socio-economic group two and the infrastructure and assets group four. In total, our sample includes 148 countries, restricted by the availability of data on both GDP size from the IMF's World Economic Outlook Database of April 2012 and total deal value activity in 2012 from SDC Platinum. Due to the lack of available historical data for some of the variables included in the five factor groups, we also restrict the time series to seven years, thus the panel data set covers the period from 2006 to 2012.

In order to standardise the country data, each variable has been converted into percentile scores, where 100% is the best achievable score in terms of the level of attractiveness/development. As we could find no support in the literature or in discussions with market practitioners for overweighting any of the factors or groupings consistently, the 23 variables were equally weighted within each factor group to determine the factor group score. Finally, each factor group's score was equally weighted in order to determine the overall score for each country.

For the purposes of analysing the drivers of M&A activity at the different stages of a country's development, the classifications provided by UNSO were followed. The use of country attractiveness classifications external to the analysis of those presented in this study leads to subjectivity in analysis of the relative importance of the different factors at play at different stages of a country's development. UNSO distinguishes between developed, developing and less developed countries – termed mature, transitional and emerging respectively – for the purposes of this paper.

This study uses the aforementioned UNSO country classifications to measure the ability of the Index to classify countries into their pre-defined stages of maturity. In order to achieve this, the study performs a linear discriminant analysis. This makes it possible to identify the ability of the Index to describe the differences between the mature, transitional and emerging economies, and exploit these differences in order to classify the sample countries into their correct membership group, i.e. their stage of development.

The restrictions on the M&A data, downloaded from SDC Platinum, follows Rossi and Volpin (2004), thus M&A in the form of LBOs, spin-offs, recapitalisation, self-tenders, exchange offers, repurchases and privatisation have been excluded. However, in contrast to the aforementioned study, our sample also includes minority purchases and purchases of remaining interest. This is due to the heavy restrictions on foreign investments in many developing countries, making not-for-control transactions the only available option for cross-border inflow. The sample is also restricted to completed transactions. For the bulk of tests in the paper, we include both domestic and cross-border data. This is because we are aiming to test the ability of our Index to determine country-level M&A activity, especially at different

[3] It should be noted that at a preliminary stage of the analysis, a larger number of variables constituted each of the five factor groups (45 in total). The number of factors for inclusion was reduced on the basis of correlation analysis and following the principle of parsimony. In addition, some of the original factors were excluded as the data is either only available for a small selection of the country sample or because it is static.

stages of country maturity. In particular, when a country is not fully mature, i.e. transitional or emerging according to our definition, we expect the drivers of domestic country-level M&A activity to be very similar in direction and significance to those of cross-border M&A activity as underdevelopment in a certain area poses the same threat for both domestic and cross-border buyers.[4] Investors and companies within these countries also purchase companies and assets outside their country, but these deals are not included. However, it should be noted that such deals might impact the overall M&A attractiveness of the domestic market. Note that throughout the following section, we present our results using both country-level M&A volume and value data. In the emerging stage of country development, the total country-level volume of transactions is the most reliable indicator of activity as these transactions tend to be very small, hence the data on the value of the transactions will often not be disclosed. As a country matures, it should start attracting larger transactions in terms of value – for which the details around the consideration are more likely to be disclosed – which in itself will spur further industry growth and larger transactions, hence the total country-level value of transactions becomes a more appropriate measure of activity.

1.4. Results

Table 1.4-A shows the overall score as well as those of each of the five major factor groups for the top 100 ranked countries for the 2012 annual update of the Index.

Table 1.4-A: MAAIS for the top 100 ranked countries in 2012.

Table 1.4-A shows the top 100 countries based on the 2012 Index ranking. *Rank* is the index ranking for 2012. *5YR* Δ is the change in ranking over the five-year period ending in 2012. *MAAIS* is the M&A attractiveness index score for 2012 per country, computed as an equal average of the five factor group scores. *MA_Vol* is the country-level M&A volume for 2012 as reported by the SDC database. *MA_Val* is the country-level M&A value ($m) for 2012 as reported by the SDC database. *RegPol* is the 2012 score for the Regulatory and Political factor group, computed as an equal average of the sub-factor variables listed in Table 1.2-A (Panel A). *EconFin* is the 2012 score for the Economic and Financials factor group, computed as an equal average of the sub-factor variables listed in Table 1.2-A (Panel B). *Tech* is the 2012 score for the Technological factor group, computed as an equal average of the sub-factor variables listed in Table 1.2-A (Panel C). *Socecon* is the 2012 score for the Socio-economic factor group, computed as an equal average of the sub-factor variables listed in Table 1.2-A (Panel D). *InfraAsst* is the 2012 score for the Infrastructure and Assets factor group, computed as an equal average of the sub-factor variables listed in Table 1.2-A (Panel E)

[4] For example, a country's lack of availability of finance or poor rule of law will have the same determining effect for domestic as for international buyers.

Country name	Rank	5YR Δ	MAAIS	MA_Vol	MA_Val	Reg-Pol	Econ-Fin	Tech	Socecon	In-frAsst
United States	1	0	87%	6,860	581,014.77	85%	82%	90%	78%	99%
South Korea	2	3	83%	755	29,073.83	78%	74%	93%	91%	79%
Singapore	3	-1	82%	256	28,517.96	93%	70%	89%	69%	92%
United King-dom	4	0	81%	1,950	98,425.01	80%	69%	91%	70%	95%
Hong Kong	5	3	80%	183	11,729.72	86%	76%	78%	73%	88%
Germany	6	-3	80%	1,014	42,509.77	76%	66%	89%	73%	97%
Canada	7	-1	80%	1,387	116,861.65	85%	78%	86%	78%	74%
France	8	1	79%	1,373	25,470.14	79%	70%	91%	64%	93%
Netherlands	9	1	79%	410	27,073.41	89%	72%	92%	61%	80%
China	10	2	78%	1,235	76,858.87	43%	82%	81%	98%	88%
Japan	11	-4	78%	1,373	65,991.56	72%	76%	91%	66%	87%
Australia	12	-1	77%	1,049	48,082.40	90%	75%	83%	68%	71%
Spain	13	1	76%	650	53,515.71	69%	73%	74%	75%	91%
Switzerland	14	-1	75%	282	56,569.65	87%	78%	93%	59%	61%
Malaysia	15	9	75%	318	15,695.53	71%	83%	85%	64%	73%
Thailand	16	2	73%	114	2,337.01	53%	79%	66%	88%	82%
Norway	17	5	72%	408	13,756.15	94%	65%	90%	47%	66%
Sweden	18	-3	72%	599	14,775.72	85%	74%	87%	48%	67%
United Arab Emirates	19	8	72%	65	2,570.70	79%	65%	59%	71%	84%
Denmark	20	-1	72%	235	9,021.87	91%	65%	88%	43%	72%
Austria	21	-5	71%	93	4,653.43	80%	59%	84%	59%	74%
Belgium	22	1	71%	156	6,035.90	75%	65%	81%	54%	79%
Czech Repub-lic	24	1	71%	117	3,759.20	58%	54%	81%	71%	90%
Italy	24	-4	71%	358	29,628.12	56%	63%	75%	67%	94%
New Zealand	25	1	71%	133	4,270.72	92%	67%	81%	46%	67%
Finland	26	-9	69%	163	2,981.21	89%	60%	84%	43%	71%
Russia	27	2	69%	1,678	89,890.31	45%	52%	73%	94%	82%
Poland	28	5	69%	151	7,441.59	52%	60%	72%	86%	75%
Ireland	29	-8	68%	108	14,008.33	74%	63%	86%	48%	70%
Luxembourg	30	0	67%	25	2,480.44	86%	65%	82%	44%	61%
Chile	31	0	67%	142	9,978.10	67%	73%	63%	72%	62%
Turkey	32	5	67%	202	11,420.17	61%	55%	57%	81%	82%
Malta	33	-5	65%	4	96.21	70%	53%	80%	48%	76%
Brazil	34	1	65%	515	41,276.70	41%	64%	69%	84%	68%
Hungary	35	-1	65%	39	278.19	66%	44%	80%	65%	69%
Slovakia	36	0	65%	17	3,614.34	63%	47%	71%	68%	74%
Portugal	37	-5	64%	48	6,894.26	68%	63%	61%	58%	70%
Mexico	38	5	64%	126	24,658.03	48%	58%	71%	70%	72%
Kazakhstan	39	9	63%	23	4,185.28	43%	49%	77%	69%	79%
Romania	40	6	63%	48	190.13	58%	47%	69%	75%	68%
Morocco	41	6	63%	11	1,171.47	49%	74%	62%	71%	57%
South Africa	42	0	62%	165	6,212.27	55%	69%	54%	69%	65%
India	43	-4	62%	616	18,595.60	36%	65%	57%	73%	81%
Qatar	44	6	62%	16	635.31	74%	68%	48%	63%	55%
Indonesia	45	4	62%	150	4,628.91	40%	61%	56%	83%	68%
Israel	46	-5	61%	5	55.61	47%	70%	81%	42%	66%
Vietnam	47	-2	61%	226	3,890.36	35%	53%	60%	91%	64%
Ukraine	48	3	60%	183	170.37	30%	50%	57%	84%	78%
Greece	49	-11	59%	44	1,296.77	48%	58%	69%	60%	60%
Colombia	50	16	59%	87	7,758.94	47%	69%	55%	70%	53%

Country name	Rank	5YR Δ	MAAIS	MA_Vol	MA_Val	Reg-Pol	Econ-Fin	Tech	Socecon	In-frAsst
Cyprus	51	-7	59%	52	3,764.47	68%	42%	78%	51%	55%
Kuwait	52	1	58%	26	3,392.31	58%	55%	51%	60%	64%
Bulgaria	53	2	58%	28	1,224.80	49%	51%	65%	59%	64%
Lithuania	54	5	57%	25	295.03	73%	48%	68%	54%	45%
Saudi Arabia	55	-3	57%	33	2,366.83	61%	55%	52%	70%	49%
Iceland	56	-16	57%	7	464.87	80%	41%	84%	35%	47%
Panama	57	16	57%	17	828.03	52%	64%	68%	38%	64%
Slovenia	58	-2	57%	19	494.53	57%	47%	69%	52%	61%
Oman	59	12	57%	15	62.17	71%	49%	48%	56%	61%
Mauritius	60	-2	57%	7	106.00	72%	56%	40%	56%	60%
Croatia	61	-4	57%	23	137.54	52%	53%	70%	52%	58%
Philippines	62	6	56%	89	3,976.73	35%	70%	68%	63%	45%
Bahrain	63	-2	56%	8	290.25	61%	66%	44%	59%	51%
Serbia	64	-4	56%	13	5.90	50%	38%	62%	61%	69%
Belarus	65	2	56%	11	5.91	54%	33%	56%	72%	64%
Estonia	66	-1	55%	30	203.02	80%	45%	74%	41%	35%
Peru	67	7	55%	101	3,308.33	52%	62%	53%	60%	47%
Latvia	68	-4	55%	26	2.84	62%	51%	71%	47%	44%
Tunisia	69	-6	55%	3	2.65	56%	54%	47%	71%	46%
Iran	70	-8	55%	2	32.50	31%	34%	46%	92%	71%
Bosnia and Herzegovina	71	15	54%	5	4.33	39%	54%	53%	61%	63%
Macedonia	72	10	54%	11	28.24	63%	48%	57%	57%	43%
Argentina	73	-19	53%	84	1,864.70	37%	35%	63%	64%	67%
Egypt	74	-4	53%	64	5,247.32	35%	52%	36%	65%	76%
Uzbekistan	75	2	52%	5	5.70	34%	39%	54%	70%	66%
Moldova	76	-1	52%	1	15.54	50%	33%	56%	63%	57%
Montenegro	77	-8	51%	1	0.00	50%	51%	50%	44%	63%
Bahamas	78	0	51%	4	145.84	62%	54%	40%	50%	53%
Lebanon	79	6	51%	10	491.50	36%	57%	49%	56%	59%
Costa Rica	80	3	51%	13	319.44	51%	42%	66%	59%	39%
Azerbaijan	81	6	51%	2	0.00	47%	33%	54%	75%	46%
Georgia	82	-1	51%	13	3.09	63%	43%	45%	58%	46%
Jordan	83	-11	51%	47	71.13	57%	63%	45%	36%	53%
Brunei	84	-5	50%	0	0.00	54%	53%	64%	48%	32%
Sri Lanka	85	-9	50%	23	357.67	39%	53%	31%	64%	62%
Pakistan	86	-6	46%	7	221.44	21%	39%	35%	65%	70%
Armenia	87	10	46%	5	22.50	52%	34%	42%	53%	47%
Trinidad and Tobago	88	1	45%	4	68.19	40%	41%	38%	58%	49%
Algeria	89	-1	45%	0	0.00	28%	38%	31%	79%	48%
Syria	90	1	45%	0	0.00	35%	54%	31%	50%	54%
Bangladesh	91	9	44%	6	19.00	19%	56%	28%	73%	45%
Dominican Republic	92	-8	44%	6	1,237.00	40%	40%	37%	47%	56%
Mongolia	93	9	44%	7	82.27	52%	42%	47%	50%	29%
Uruguay	94	-4	43%	27	295.93	53%	29%	56%	35%	42%
El Salvador	95	14	43%	3	802.15	42%	49%	39%	40%	45%
Cape Verde	96	9	42%	0	0.00	60%	51%	29%	26%	45%
Kenya	97	1	42%	9	131.43	25%	53%	45%	49%	40%
Mozambique	98	12	42%	5	50.33	39%	48%	47%	39%	36%
Albania	99	5	42%	1	0.50	50%	48%	34%	52%	24%
Jamaica	100	-6	41%		0.00	39%	36%	36%	35%	61%

The US remains in the top spot, mirroring its position in terms of global M&A activity (currently 21% of global volume (SDC Platinum)), with the UK in fourth position. However, we note that three Asian countries occupy top five positions, with South Korea, Singapore and Hong Kong in second, third and fifth place, respectively. Further analysis of the database leads us to conclude that Singapore's and Hong Kong's high rankings are driven mainly by their highly developed infrastructure, the availability of sizeable assets to purchase (measured as the number of companies with assets valued at $1m or higher) and business-friendly regulatory environments. This is in contrast to most of the remaining top ten countries, their competitive advantage mainly being their highly developed technological environments, including high levels of high-tech exports and innovation in terms of patents filed, indicating an extremely skilled business community which should attract investment interest.

In Table 1.4-A, we are also able to see trends in M&A attractiveness over the last five years, which should help in determining future markets for M&A activity. Among the countries characterised by a significant jump in MAAIS ranking, Malaysia and the UAE stand out from the rest of the top 25 ranked countries, climbing nine and eight places respectively in the ranking over the last five years. Further analysis of the underlying data in the database reveals that both Malaysia and the UAE's rankings are mainly driven by an improvement of 6% and 2% respectively in regulatory and political factors over the five-year period. Further down the top 50 table, we find that Colombia, Poland, Romania, Turkey, Norway, Mexico, Qatar, Kazakhstan and Morocco are the front-runners in terms of improvement in their scores over the last five years as they have all risen by at least five places over that period. Not surprisingly, the rise in the rankings of developing countries has often come at the expense of developed countries in Europe. Most notably, Greece has lost significantly in terms of relative attractiveness for M&A, falling 11 places over the last five years.

Table 1.4-B provides the descriptive statistics of the average Index score and the five major factor groups at different levels of M&A volume and value activity. Both levels of M&A activity appear to increase in line with the overall MAAIS as well as the scores corresponding to the five factor groups, providing evidence that the Index closely corresponds to country-level M&A activity.

Table 1.4-B: Average Index score and factor group scores at different levels of country M&A activity

This table shows the average M&A attractiveness score and factor group score for five sub-samples of countries, classified into percentiles determined by their yearly (logged) M&A volume or (logged) M&A value activity for 2012. *MA_Vol* is the maximum M&A volume (logged) for 2012 for each percentile group. *MA_Val* is the maximum M&A value ($m, logged) for 2012 for each percentile group. *MAAIS* is the average M&A attractiveness index score for 2012 per percentile country group. *RegPol* is the average Regulatory and Political factor group score for 2012 per percentile country group. *EconFin* is the average Economic and Financial factor group score for 2012 per percentile country group. *Tech* is the average Technological factor group score for 2012 per percentile country group. *Socecon* is the average Socio-economic factor group score for 2012 per percentile country group. *InfraAsst* is the average Infrastructure and Assets factor group score for 2012 per percentile country group.

Panel A: M&A volume activity

Percentile	MA_Vol	MAAIS	RegPol	EconFin	Tech	Socecon	InfrAsst
20	1.16	38%	39%	42%	34%	40%	34%
40	2.08	42%	42%	44%	39%	47%	41%
60	2.93	49%	48%	49%	48%	52%	48%

80	4.57	62%	57%	57%	65%	63%	65%
100	6.70	66%	63%	64%	71%	64%	70%

Panel B: M&A value activity

Percen-tile	MA_Val	MAAIS	RegPol	EconFin	Tech	Socecon	InfrAsst
20	1.13	40%	41%	42%	37%	43%	36%
40	4.23	42%	43%	44%	39%	45%	40%
60	6.29	49%	46%	48%	47%	53%	49%
80	8.31	60%	55%	58%	63%	61%	62%
100	10.70	66%	63%	64%	70%	64%	69%

In order to determine the drivers of M&A at different stages of development, we use the development classifications devised by UNSO. According to these classifications, countries are divided into three stages of development for the purposes of M&A investment: mature (consisting of countries which are classified as 'developed' by UNSO), transitional (consisting of countries which are classified as 'developing' by UNSO) and emerging (consisting of countries which are classified as 'less developed' by UNSO).

We first test the fit of UNSO's classifications of market development with the MAAIS using a discriminant analysis technique. Table 1.4-C shows the results of the analysis using both the overall Index score (Panels A and B) as well as its constituent groups (Panels C and D) to distinguish between the different stages of a country's development.

Table 1.4-C: Discriminant analysis

This table presents the results from a linear discriminant analysis which aims to test the ability of the M&A attractiveness score (Panels A and B) and the five factor groups (Panels C and D) to classify countries into the correct market development categories (i.e. developed, developing and less developed) obtained from UNSO. The table shows the number and percentage of correctly classified countries as well as the number and percentage of misclassified countries at each stage of development. In addition, the analyses in Panels A and C are based on equal prior probabilities (i.e. each country is assumed to be equally likely to belong to any of the three development categories obtained from UNSO) whereas the analyses in Panels B and D are based on proportional probabilities (i.e. the prior probabilities are adjusted for the fact that there are a different number of countries belonging to each UNSO development category).

Panel A: Analysis based on the MAAIS score - Proportional priors

True	Classified			
	Mature	Transitional	Emerging	Total
Mature	167	78	0	245
	68.16%	31.84%	0.00%	100%
Transitional	70	513	33	616
	11.36%	83.28%	5.36%	100%
Emerging	0	67	108	175
	0.00%	38.29%	61.71%	100%
Correctly classified	167	513	108	788
	68.16%	83.28%	61.71%	76.06%
Total	237	658	141	1,036
	22.88%	63.51%	13.61%	100%

Panel B: Analysis based on the MAAIS score - Equal priors

True	Classified			
	Mature	Transitional	Emerging	Total
Mature	199	46	0	245
	81.22%	18.78%	0.00%	100%
Transitional	132	302	182	616
	21.43%	49.03%	29.55%	100%
Emerging	0	7	168	175
	0.00%	4.00%	96.00%	100%
Correctly classified	199	302	168	669
	81.22%	49.03%	96.00%	65%
Total	331	355	350	1,036
	31.95%	34.27%	33.78%	100%

Panel C: Analysis based on the five factors groups - Proportional priors

True	Classified			
	Mature	Transitional	Emerging	Total
Mature	202	43	0	245
	82.45%	17.55%	0.00%	100%
Transitional	30	534	52	616
	4.87%	86.69%	8.44%	100%
Emerging	0	61	114	175
	0.00%	34.86%	65.14%	100%
Correctly classified	202	534	114	729
	82.45%	86.69%	65.14%	82.04%
Total	232	638	166	1,036
	22.39%	61.58%	16.02%	100%

Panel D: Analysis based on the five factors groups - Equal priors

True	Classified			
	Mature	Transitional	Emerging	Total
Mature	224	21	0	245
	91.43%	8.57%	0%	100%
Transitional	57	425	134	616
	9.25%	68.99%	21.75%	100%
Emerging	0	15	138	175
	0%	8.57%	91.43%	100%
Correctly classified	224	425	138	719
	91.43%	68.99%	78.86%	80.97%
Total	281	461	294	1,036
	27.12%	44.50%	28.38%	100%

The discriminant analysis confirms that the initial classification process classifies 76% of countries at the correct level of maturity based on the overall Index score and 82% at the correct level of maturity based on the five major factor groups which constitute the Index.[5] Two conclusions can be drawn from this. Firstly, in both cases (i.e. based on the overall score and the five major factor groups), the results are stronger when using proportional prior probabilities as opposed to using equal prior probabilities. This finding is not surprising given the fact that the number of sample countries which belong to each stage of development differs substantially, with transitional economies accounting for the highest proportion (59% of the sample), followed by mature economies (24%) and emerging economies (17%). Secondly, the results are stronger when using the five major factor groups, where the model correctly classifies 82% of the countries (Table 1.3-C, Panel A), as opposed to using the overall score, where the model correctly classifies only 76% of the countries. This finding demonstrates that there are informational advantages in using the five major factor groups as opposed to the overall M&A attractiveness index. This is due to the fact that the overall index gives equal weight to each of the five constituent factor groups and, as argued in this study, each factor group can be relatively more or less important depending on the stage of maturity of a given country.

1.4.1. Drivers of country-level M&A activity at different stages of market maturity

Table 1.4.1-A shows the results of the univariate analysis of the average[6] Index score depending on market maturity. As demonstrated by the analysis, the difference between the mature stage of development and the developing stages – transitional and emerging – is greatest in terms of regulatory and political development as well as technological advancement. These results show that the quality of a country's regulatory system, its political stability and a developing technological environment are all prerequisites for a market to reach the stage of mature development, supporting the work of Rossi and Volpin (2004), Guerin and Manzocchi (2009), Yartey (2008) and Porter (1993).

[5] These percentages are based on the use of proportional prior probabilities.

[6] Note that in an unreported table, we tested the differences in medians between the three stages of market attractiveness and concluded that the results are not materially different from the analysis of averages.

Table 1.4.1-A: Univariate analysis - Average MAAIS score and average factor group scores for different stages of market attractiveness

This table presents the average M&A attractiveness score (*MAAIS*) and factor group scores (*RegPol*, *EconFin*, *Tech*, *Socecon* and *InfraAsst*) for 148 countries for the seven years of the sample period. The table also shows the corresponding average for the three sub-samples of country development – mature, transitional and emerging – as well as the results from unpaired mean comparison tests (Dixon and Massey Jr., 1983; and Hoel, 1984). ***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

	Observa-tions/ (De-grees of freedom)	MAAIS	RegPol	EconFin	Tech	Socecon	InfrAsst
All	1,036	52%	50%	52%	52%	54%	52%
Mature (1)	245	70%	74%	62%	81%	62%	72%
Transitional (2)	616	50%	46%	51%	48%	55%	52%
Emerging (3)	175	32%	33%	40%	25%	37%	25%
diff. (1) - (2) (pp)		**0.20*** **	**0.29*** **	**0.11*** **	**0.32*** **	**0.06*** **	**0.19*** **
t-stat	(859)	22.23	25.20	10.93	27.52	4.86	14.84
diff. (2) - (3) (pp)		**0.18*** **	**0.12*** **	**0.11*** **	**0.23*** **	**0.18*** **	**0.28*** **
t-stat	(789)	18.62	9.76	9.53	16.48	11.80	19.32
diff. (1) - (3) (pp)		**0.38*** **	**0.41*** **	**0.22*** **	**0.55*** **	**0.24*** **	**0.47*** **
t-stat	(418)	52.32	34.69	20.46	52.96	20.39	35.80

Multivariate regression analysis is performed on the country-year panel data set, covering seven years from 2006 to 2012, in order to determine which factor groups explain the differences in M&A activity between all of the sample countries as well as between countries at different stages of maturity. Table 1.4.1-B shows the results of a regression analysis of the relationship between M&A activity as the dependent variable – measured both in terms of volume (Panel A) and value (Panel B) – and the five factor groups as the explanatory variables. In addition, we test the explanatory power of the five individual factor groups with cross-border M&A data only (Panel C and Panel D).

Table 1.4.1-B: Multivariate regression analysis – Drivers of M&A activity

This table presents the results from the panel data regression analysis of the factor groups (*RegPol*, *EconFin*, *Tech*, *Socecon* and *InfraAsst*) which explain M&A activity for the 148 countries included in this study for the period 2006 to 2012. Model 1 presents the analysis of drivers of M&A activity on the basis of a sample of all the countries included in this study and Models 2, 3 and 4 present the analysis of the drivers of M&A activity on the basis of sub-samples of countries at the mature, transitional and emerging stages of their development. Countries are classified as mature, transitional or emerging on the basis of the definition used by UNSO. Panel A presents the results when M&A activity is measured by logged M&A volume (*MA_Vol*) and Panel B presents the results when M&A activity is measured by logged M&A value (*MA_Val*). Panel C presents the results when M&A activity is measured by logged cross-border M&A volume (*CB_MA_Vol*) and Panel D presents the results when M&A activity is measured by logged cross-border M&A value (*CB_MA_Val*). Z-scores are reported below each independent variable. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions

of our independent variables and regression residual are not independent and identically distributed (i.i.d.), all of the models have a robust estimate of variance following Huber (1967) and White (1980, 1982). ***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

Panel A: Regression analysis of the relationship between M&A volume and the five major factors constituting the MAAIS

Dependent variable: MA_Vol	Model 1	Model 2	Model 3	Model 4
	All	Mature	Transitional	Emerging
RegPol	**1.516*** **	**1.470***	0.148	1.320
	3.020	1.720	0.240	0.880
EconFin	**1.692*** **	1.412	**2.185*** **	-0.861
	3.100	1.350	3.040	-1.110
Tech	**1.628*** **	**5.200*** **	**2.030*** **	-0.465
	4.120	4.310	4.130	-0.700
Socecon	**3.768*** **	**6.737*** **	**3.079*** **	1.793
	5.390	8.020	3.370	1.310
InfrAsst	**2.071*** **	**1.647** **	**1.861*** **	1.379
	4.530	2.570	3.000	1.120
Constant	**-2.309*** **	**-6.131*** **	**-1.501*** **	0.291
	-8.250	-5.810	-4.120	0.340
Number of observations	1,036	245	616	175
Wald Chi squared (five degrees of freedom)	473.87	154.55	171.29	16.16
Adjusted R^2	0.5396	0.5667	0.3996	0.0214
Chi^2 test for difference in regression coefficients				
A. Between the three country groups	**47.90*** **			
B. Between mature countries and the other country groups		**53.81*** **		
C. Between transitional countries and the other country groups			**26.27*** **	
D. Between emerging countries and the other country groups				**50.41*** **

Panel B: Regression analysis of the relationship between M&A value and the five major factors constituting the MAAIS

Dependent variable: MA_Val	Model 1	Model 2	Model 3	Model 4
	All	Mature	Transitional	Emerging
RegPol	**1.758***	**4.966** **	-0.077	-4.540
	1.950	2.350	-0.070	-1.330
EconFin	**5.920*** **	**7.977*** **	**6.509*** **	-2.788
	5.550	3.440	5.140	-1.130
Tech	**2.061** **	1.952	**2.651** **	-2.891
	2.210	1.410	2.320	-1.360
Socecon	**4.343*** **	**8.538*** **	**3.988*** **	0.981
	3.550	8.301	2.700	0.260

InfrAsst	**3.644*** **	**2.478***	**3.021*** **	4.868
	3.790	1.850	2.270	1.530
Constant	**-3.417*** **	**-8.180*** **	**-2.860*** **	**4.570** **
	-6.990	-4.850	-4.680	2.110
Number of observations	1,036	245	616	175
Wald Chi squared (five degrees of freedom)	558.07	392.87	470.39	22.54
Adjusted R^2	0.3721	0.5287	0.2403	0.0256
Chi^2 test for difference in regression coefficients				
A. Between the three country groups	**67.70*** **			
B. Between mature countries and the other country groups		**44.12*** **		
C. Between transitional countries and the other country groups			**17.39*** **	
D. Between emerging countries and the other country groups				**31.03*** **

Panel C: Regression analysis of the relationship between cross-border M&A volume and the five major factors constituting the MAAIS

Dependent variable: CB_MA_Vol	Model 1	Model 2	Model 3	Model 4
	All	Mature	Transitional	Emerging
RegPol	**1.390*** **	**2.038** **	-0.142	1.328
	3.010	2.350	-0.270	1.190
EconFin	**1.222** **	0.051	**1.931*** **	-1.226
	2.330	0.040	3.200	-1.560
Tech	**1.259*** **	**3.842*** **	**1.615*** **	-0.593
	3.250	2.900	3.650	-0.850
Socecon	**3.034*** **	**8.141*** **	**1.928*** **	**1.674** *
	5.050	10.070	2.650	1.710
InfrAsst	**1.684*** **	0.389	**1.738*** **	0.833
	4.180	0.950	3.250	0.830
Constant	**-2.015*** **	**-5.733*** **	**-1.416*** **	0.227
	-8.210	-9.210	-4.600	0.340
Number of observations	1036	245	616	175
Wald Chi squared (five degrees of freedom)	470.39	274.28	173.63	17.30
Adjusted R^2	0.522	0.469	0.383	0.025
Chi^2 test for difference in regression coefficients				
A. Between the three country groups	**165.15*** **			
B. Between mature countries and the other country groups		**83.87*** **		
C. Between transitional countries and the other country groups			**55.42*** **	
D. Between emerging countries and the other country groups				**80.42*** **

Panel D: Regression analysis of the relationship between cross-border M&A value and the five major factors constituting the MAAIS

Dependent variable: CB_MA_Val	Model 1	Model 2	Model 3	Model 4
	All	Mature	Transitional	Emerging
RegPol	**1.631***	**6.568*****	-0.777	-0.389
	1.730	3.040	-0.730	-0.130
EconFin	**5.444*****	**7.391****	**6.150*****	-2.543
	4.440	2.170	4.240	-0.980
Tech	**1.969****	**-0.730**	**2.270***	-1.676
	2.000	-0.270	1.790	-0.840
Socecon	**3.666*****	**11.137*****	**2.916****	1.095
	3.130	5.130	2.130	0.340
InfrAsst	**3.779*****	1.162	**3.837*****	2.917
	3.850	0.820	2.870	0.870
Constant	**-3.749*****	**-8.784*****	**-2.967*****	2.361
	-7.790	-5.260	-4.560	1.200
Number of observations	1036	245	616	175
Wald Chi squared (five degrees of freedom)	565.03	142.00	198.39	5.34
Adjusted R^2	0.3215	0.3858	0.1776	0.0152
Chi^2 test for difference in regression coefficients				
A. Between the three country groups	**59.88*****			
B. Between mature countries and the other country groups		**39.40*****		
C. Between transitional countries and the other country groups			**21.15*****	
D. Between emerging countries and the other country groups				**27.18*****

In Panels A and B (Model 1), we confirm that all five factor groups individually explain some of the differences in country-level M&A volumes. The analysis shows that, in line with other authors, regulatory and political factors (Rossi and Volpin, 2004; DeLong et al., 2001; and Yartey, 2008), economic and financial factors (Berthelemy and Demurger, 2000; Liu et al., 2009; Yartey, 2008; and Saborowski, 2009), as well as technological (Porter, 1993), are positively and statistically significant determinants of M&A activity, in terms of both volume and value. This paper adds to the existing literature by proving the existence of a positive relationship between M&A activity and a country's socio-economic development, i.e., population size as well as the percentage of working age people. We also demonstrate that there is a positive relationship between M&A activity and the quality of a country's infrastructure and assets, i.e., the availability of adequate roads, railway lines and ports as well as the availability of sizeable assets to acquire. Panels A and B (Models 2 to 4) also provide insight into the relative degree to which the five factor groups are responsible for variations in M&A activity at the three stages of country development.[7] Notably, we find that a

[7] Following the Chow (1960) test methodology, we estimate an equation of the form: M&A_Activity = β_1RegPol + β_2EconFin + β_3Tech + β_4Socecon + β_5InfraAsst + β_6RegPol x *Transitional* + β_7EconFin x *Transitional* + β_8Tech x *Transitional* + β_9Socecon x Transitional + β_{10}InfraAsst x *Transitional* + β_{11}RegPol x *Emerging* + β_{12}EconFin x *Emerging* + β_{13}Tech x Emerging + β_{14}Socecon x Emerging + β_{15}InfraAsst x *Emerging* + β_{16}Transitional_Dummy + β_{17}Emerging_Dummy. In order to test whether the coefficients corresponding to each of the factor groups are

country's regulatory and political environment is only a significant determinant of country-level M&A activity for countries in the mature country group. Thus, our findings extend the existing body of research by showing that the development of the regulatory and political environment is not a significant determinant of M&A activity for countries which are less developed, where other factors, such as their economic and financial, technological and socio-economic development, as well as the quality of their infrastructure and assets, have been accounted for. However, as discussed earlier, the quality of a country's regulatory environment and its political stability appears to be a prerequisite for the highest level of development. As can be seen in both Panel A and Panel B, Model 3, in the transitional stage of country development, all of the factor groups except regulatory and political appear to drive both M&A volume and value activity. As countries move to the mature stage, the economic and financial factor group becomes less significant when it comes to M&A volume activity as does the technological factor group when it comes to M&A value activity. As demonstrated in Panels A and B, Model 4, the multivariate regression of the five factor group scores which constitutes the MAAIS is overall a poor fit with emerging markets' country-level M&A activity. We conclude that M&A activity in countries at an emerging stage of development are likely to be driven by a very different set of determinants, such as the abundance of natural resources. However, this result is also a reflection of little variation within the other factor scores as all of the countries which belong to this stage of maturity have to play catch-up in all of the areas which drive M&A activity.

All of the aforementioned conclusions hold when we restrict the sample data to cross-border country-level M&A data only (Table 1.4.1-B, Panels C and D). We conclude that five factor groups, and by extension the MAAIS, are – as hypothesised – all important drivers of country-level M&A activity, both domestic and cross-border.

1.4.2. Testing the forecasting power of the MAAIS

Finally, it is useful to analyse the ability of the MAAIS to predict future M&A activity. Table 1.4.2-A, Panel A examines its ability to predict M&A volume activity while Table 1.4.2-A, Panel B tests value activity. Each of the regression models presented in Table 1.4.2-A is based on the following general equation:

M&A_Activity year 0 = βkM&A_Activity year – t + βjMAAIS year 0 + βjMAAIS year – t

statistically significantly different from each other across the three country groups, we test whether the coefficients β_6 to β_{17} are jointly significantly different from zero. The Chi^2 test statistic, as reported in Table 6, Panels A to D, is highly statistically significant and we can therefore reject the hypothesis that the coefficients β_6 to β_{17} are jointly equal to zero. We perform two additional Chow tests to ascertain the difference in regression coefficients between transitional countries relative to the other country groups and between emerging countries relative to the other country groups. The former test consists of assessing whether coefficients β_6 to β_{10} and β_{16} are jointly equal to zero and the latter of assessing whether coefficients β_{11} to β_{15} and β_{17} are jointly equal to zero. The tests statistics associated with both tests are highly statistically significant and we therefore conclude that the regression coefficients corresponding to each of the five factor groups are statistically significantly different from each other at the three different levels of country development for M&A purposes.

where the MAAIS is the M&A attractiveness score for each country and year, M&A Activity is measured by the natural logarithm of M&A volume (Panel A) or the natural logarithm of M&A value (Panel B) and the number of time lags t goes up to five years.

The purpose of the above equation is to determine the ability of the MAAIS to predict M&A activity after accounting for other important predictors. We use previous M&A activity (from t-1 to t-5) in order to capture the effect of these other predictors. The results presented in Table 1.4.2-A, Panel A demonstrate that the scores corresponding to years t-2 (Models 4 and 6), t-3 (Models 4 and 6) and t-4 (Model 6) are statistically significant determinants of M&A volume activity. This finding provides statistical evidence that the M&A attractiveness score can be used to predict future M&A activity. Intuitively, the finding that the predictive power of the attractiveness score is present over a three-year time period (i.e. from t-4 to t-2) can be explained by the fact that the MAAIS is a relatively stable measure on a year-to-year basis, with major changes taking place over a period of time which is greater than one year. In untabulated results, we test the opposite relationship, i.e. whether M&A volume activity causes the M&A attractiveness score. The Granger causality tests show that the coefficients corresponding to the M&A attractiveness score in years t 0 and t-2 are jointly significantly different from zero. This is interpreted as evidence in favour of the hypothesis that M&A volume activity causes the M&A attractiveness score when considering a time period of one year before the current year. We therefore conclude that a fundamental prerequisite for the development of a country's M&A market are the five factor groups which underlie the MAAIS as the score has a more persistent time effect on M&A volume activity, materialising over a period of three years. However, we also recognise that the opposite relationship shows some causality. These results are not intuitively surprising as we would expect that M&A activity in yeart-1 would improve the attractiveness for M&A activity in yeart0 due to positive spillover effects.[8]

In Table 1.4.2-A, Panel B, we confirm that the same conclusion can be made for the ability of the MAAIS to predict M&A value activity, i.e. that the MAAIS is a better predictor of M&A value than vice versa although the opposite relationship also shows some level of causality.

[8] For example, M&A transactions will specifically increase the availability of sizeable assets, whilst GDP size and high-technology exports are likely to increase with better allocation of capital. Also, the regulatory environment is expected to improve as a result of investments by firms from more mature and transparent markets.

Table 1.4.2-A: Granger causality tests.

This table shows an analysis of the ability of the M&A attractiveness index to predict future M&A value activity (Panel A) and M&A volume activity (Panel B). The general form of the equation estimated in each model is: $M\&A\_Activity_{year\ 0} = M\&A\_Activity_{year-t} + MAAIS_{year\ 0} + MAAIS_{year-t.}$ The table also shows the result of a Granger Causality test between the M&A attractiveness score (*MAAIS*) and logged M&A volume (*MA_Vol*) and logged M&A value (*MA_Val*) as well as the statistical significance of the Chi^2 test statistic. All models are estimated on the basis of a panel regression specification in which each country and year represents the two dimensions of the panel. Z-scores are reported under each independent variable. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent and identically distributed (i.i.d.), all of the models have a robust estimate of variance following Huber (1967) and White (1980, 1982). ***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

Panel A: Granger causality test of the MAAIS on M&A Volume

Dependent variable: MA_Vol	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
MAAIS	**1.423*** **	**2.053***	0.237	-0.511	-0.444	-0.878
	7.570	1.730	0.150	-0.290	-0.210	-0.360
L1_MA_Val	**0.865*** **	**0.866*** **	**0.707*** **	**0.684*** **	**0.657*** **	**0.597*** **
	51.350	50.980	15.600	11.780	10.190	7.580
L1_MAAIS		-0.638	0.324	0.251	0.336	-0.833
		-0.530	0.170	0.110	0.110	-0.200
L2_MA_Val			**0.210*** **	**0.107***	0.059	0.014
			4.460	1.660	0.790	0.150
L2_MAAIS			0.211	**4.806** **	3.345	**7.071***
			0.160	2.200	1.140	1.940
L3_MA_Val				**0.157*** **	**0.130** **	0.086
				3.570	2.090	1.170
L3_MAAIS				**-4.251** **	-0.962	**-7.523** **
				-2.580	-0.380	-2.010
L4_MA_Val					**0.115** **	**0.285*** **
					2.200	3.350
L4_MAAIS					-2.071	**4.846***
					-1.280	1.680
L5_MA_Val						-0.023
						-0.320
L5_MAAIS						-2.554
						-1.320
Constant	**-0.310*** **	**-0.309*** **	**-0.194*** **	-0.075	-0.091	-0.153
	-6.340	-6.300	-3.330	-1.240	-0.840	-1.200
Number of observations	817	817	664	520	383	250
Wald chi^2	22758.08	22925.96	22697.14	17371.57	12197.81	7879.42
F-stat (Granger causality test)	**57.34*** **	**59.78*** **	**14.53*** **	**10.18** **	3.99	8.16

Panel B: Granger causality test of the MAAIS on M&A Value

Dependent variable: MA_Val	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
MAAIS	**7.811*** **	**9.232***	6.861	8.397	2.404	12.214
	9.820	1.650	1.110	1.170	0.290	1.110
L1_MA_Val	**0.505*** **	**0.505*** **	**0.335*** **	**0.365*** **	**0.300*** **	**0.239*** **
	11.750	11.820	8.550	7.180	5.240	3.940
L1_MAAIS		-1.428	-14.690	**-21.913***	-19.998	**-35.420***
		-0.260	0.136	-1.690	-1.280	-1.880
L2_MA_Val			**0.238** **	**0.195*** **	**0.178** **	**0.163***
			4.900	3.070	2.410	1.930
L2_MAAIS			**14.406*** **	**25.702** **	**30.263*** **	**41.711*** **
			2.160	2.480	3.030	2.950
L3_MA_Val				**0.228*** **	**0.167** **	0.079
				4.190	2.320	0.880
L3_MAAIS				-9.556	4.716	-8.330
				-1.420	0.500	-0.620
L4_MA_Val					**0.228*** **	**0.335*** **
					3.440	3.370
L4_MAAIS					**-16.267*** **	-6.007
					-2.720	-0.530
L5_MA_Val						0.086
						1.160
L5_MAAIS						-2.834
						-0.370
Constant	**-1.112*** **	**-1.112*** **	**-0.987*** **	-0.265	0.029	-0.499
	-4.280	-4.280	-3.350	-1.070	0.090	-1.130
Number of observations	817	817	664	520	383	250
Wald chi^2	1692.31	1691.59	1692.79	2044.33	1407.59	926.03
F-stat (Granger causality test)	**96.45*** **	**97.84*** **	**55.88*** **	**17.31*** **	**22.99*** **	**12.56***

1.5. Conclusion

The paper provides a proprietary methodology for measuring a country's attractiveness for M&A purposes. Each country's regulatory and political, economic and financial, technological and socio-economic environments, as well as the quality of its infrastructure and assets, are measured in order to provide an overall country- and year-specific index score. By studying the factor scores at different stages of a country's development, we conclude that technological advancement as well as the quality of the country's regulatory system and its political stability are prerequisites to becoming a mature – and therefore attractive – market for M&A purposes. The findings of the paper also provide support for previous studies examining macro- and micro-economic determinants of M&A activity, proving that all of the factor groups in the Index – regulatory and political, economic and financial, technological, socio-economic and infrastructure and assets – are significantly related to M&A activity. However, we extend the findings of previous studies by suggesting that there is a significant difference between the relationship of the five factor group variables which constitute the Index and M&A activity, dependent on the country's stage of development. The results show that for a transitional stage country, its economic and financial, technological and socio-economic factors, as well as the quality of its infrastructure and assets, become determinants of M&A activity. As the country moves towards a fully mature stage of development, all of the factor groups are found to be significant drivers of M&A activity, hence at this stage of maturity the quality of the country's regulatory environment and its political stability are also significant determinants of country-level M&A activity.

According to Tong, Alessandri, Reur and Chintakananda (2008), it is country, as opposed to industry, effects which influence the performance of companies involved in cross-country investment activities. Hence, we suggest that the ability to determine a country's M&A attractiveness can contribute to a better understanding of the factors which affect the performance of companies involved in acquisitions, particularly cross-border acquisitions. In addition, knowledge of a country's M&A attractiveness can also provide deeper insight not only of firm-level drivers of financial performance but also of country-level drivers of economic and financial progress, as shown by the two-way causal relationship between M&A activity and country development. Furthermore, an accurate measure of country-level drivers of M&A activity can shed light on the capacity of a given country to develop and sustain M&A activity levels, hence making it possible to forecast medium- and long-term future M&A activity in that country.

This updatable index can help acquiring companies in their investment decisions related to the acquisition of a stake in a company based in a country outside the location of the acquirer's headquarters. It should be stressed that this type of investment decision may ultimately be determined principally by factors unique to the specific company being acquired (such as the target company's financial situation, management, market position, intellectual property, etc.), although, as shown in this paper, factors unique to each country within which a company operates are also critical. Therefore, knowledge of the level of M&A attractiveness of each country is vital both at an aggregate level and within each group of factors, and the M&A attractiveness index devised by this study will hopefully provide acquiring companies with a tool which they can use to assess investment decisions.

2. Naked M&A transactions: How the lack of local expertise in cross-border deals can negatively affect acquirer performance – and how informed institutional investors can mitigate this effect

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Abstract

We test how informed investors with local expertise can affect cross-border deal success using a comprehensive dataset of corporate acquirers' share registers. We posit that deals in which long-term investors have a high level of expertise in the target firm's region are more likely to perform better than if the deal is 'naked', i.e. when such regional expertise amongst the investors is low. We show that the strength of this effect depends upon an index of country-level M&A maturity which measures the relative divergence between acquirer and target countries. Specifically, we investigate whether acquirers investing in countries with low M&A maturity gain greater benefit from investors with regional expertise. We present evidence which confirms the hypothesis that acquirers in cross-border corporate transactions are more likely to be successful if the acquirer's investors have a higher level of expertise in the target region, and that this effect is strongest when the maturity for corporate transactions of the target country is low. This provides a specific setting which is consistent with earlier theoretical work that argues in general that information flows should not just be from firms to capital markets but also in the opposite direction, and that this flow of information is particularly important whenever information is dispersed.

2.1. Introduction

Ferreira, Massa and Matos (2009), hereafter FMM, consider cross-border M&A deals and find (Subsection 4.3) that the extent to which a deal is value-increasing depends on whether there is foreign institutional ownership of the companies. Specifically, they find (p. 640) that "foreign institutional ownership in both target and acquirer firms is associated with higher combined returns in cross-border deals. This is consistent with the "facilitation hypothesis" that foreign institutions promote deals that offer greater value creation (synergy)." They argue that this is because foreign institutional investors may reduce transaction costs and informational asymmetries between potential acquirers and targets. However, they do not propose in detail how these advantages arise.

Building upon the theory of Financial Geography and the work of Dye and Sridhar (2003), we argue that the reason that the holdings of foreign institutional investors is positively associated with the performance of acquirer returns is because a subset of the investors may hold key expertise in the target region. That is, in an economic setting in which information is hard to gather and diverse in nature, it may be reasonably argued that those investors with regional expertise hold information which the management of the acquirer finds hard to collect. Thus, they may have a role to play in reducing cross-border M&A deal informational asymmetries. To summarise, one goal of this research is to refine the earlier hypotheses of FMM in order to

provide a more nuanced understanding of the specific reasons behind the observation of this positive association.

In order to try to detect these effects, we conduct this research at acquirer share register level and measure the success of transactions at deal level. Additionally, since we argue here that the effects are most likely to arise with those institutional investors who are both knowledge-intensive and who have regional expertise, the investor sample is further refined. First, we split institutional investors into those who are relatively more knowledge-intensive (informed) versus those who are not. The latter group includes those who only invest in specific stocks for very short periods of time and, therefore, are not assumed to conduct detailed firm-level analyses. Second, in order to identify informed institutional investors, we conduct an analysis of the company share registers which they invest in to ascertain their portfolio allocation, which we then use as a proxy for measuring regional expertise. We, therefore, suggest that simply looking at aggregate institutional investor holdings is an imperfect measure of the potential for reductions in informational asymmetries by acquirer firms learning from institutional investors. Instead, we test to see whether the holding positions in the target region of informed institutional investors is positively associated with post-M&A deal performance. Our statistically significant results confirm the above thesis.

In addition, we posit that this two-way communication is of particular importance when the acquiring firm is investing in a country where the maturity for corporate investment purpose is low, which we relate to the relatively higher information asymmetry in these situations. Thus, we suggest that the relationship established by FMM between the composite of investors on the share register and deal success is due to a reduction in information asymmetry. This effect is most marked when the investment is being made in countries with less developed M&A markets. Our conclusions add to the existing literature by highlighting the importance of maintaining in general terms a constructive dialogue with long-term and strategically-savvy investors about M&A programmes and strategies.

This paper is organised as follows: Section 2.2 is a review of the literature on financial geography, the choices open to management of strategic options contingent on market reaction and other related literature which can be used to provide support for our aforementioned primary hypothesis; Section 2.3 discusses the data sources, provides a description of the data and a full list of variables; Section 2.4 presents empirical tests of the hypotheses and robustness tests; and the conclusion is presented in Section 2.5.

2.2. Related literature

This section considers the previous literature on the benefits which can accrue to the management of an acquirer by consulting its investors when it is considering making a cross-border M&A deal. With regard to this, it has long been recognised (see, for instance, Jennings and Mazzeo, 1991) that when an initial M&A bid is issued, the management of the potential acquirer needs to be cognisant of the stock market reaction to the initial announcement. For instance, shortly after Hewlett Packard (HP) withdrew from a much touted potential deal with

PwC, HP's CEO, Carly Fiorina, stated, "I recognise that a number of you verbalised your concerns over the past few weeks, and others simply voted with their positions in the stock. ... I realise you made some valid points."[9]

Expressed more generally, Dye and Sridhar (p.389, 2003) argue that "The existing literature … primarily views the information flows between firms and the capital market as one way - from firms to the capital market. This paper is premised on information flows also occurring from capital markets to firms…" In their model, investors form an opinion on the potential (net cash flow) prospects associated with an option to invest in a project, here interpreted as an M&A deal. Furthermore, they argue that information about the potential success of the new deal project is widely dispersed and it is reasonable to assume that the management of the acquirer will want to have access to some of the information held by others before making a decision on whether or not to invest. Hence, the only way that management can access information on the value of a new project is by observing the reaction of investors - in terms of aggregate price - when it is announced that the potential deal is 'live'. Just as in the real case of HP above, management can choose to back out of the deal if the price reaction is sufficiently negative.

However, we note that there may be other ways in which the management of the acquirer can learn from investors. For example, the senior management of firms meet their major institutional investors on a regular basis and talk in general terms about strategy. Holland (2006), for instance, discusses how senior management and institutional investors exchange information while staying within the spirit of disclosure regulations such as Regulation Fair Disclosure (Reg FD) in the US or the equivalent in other locations. It is, for instance, not illegal for senior management to ask institutional investors what factors, in their view, determined the success or failure of deals in which they had a position. In addition, they can talk about the general economic performance of and ease of doing business in certain foreign countries and, in general terms, the desirability of foreign acquisitions in order to, for instance, get an early toe hold in an emerging economy without naming any specific targets. Management can use such carefully conducted meetings in order to collect information and, in principle, learn from knowledgeable institutional investors. For example, before a UK company considers any specific acquisitions in Brazil, it could be helpful to hear from informed institutional investors what socio-political and regulatory constraints previous UK-Brazil deals had encountered. If that company is in the oil sector and considering an acquisition in Brazil, it could be instructive to hear what role the Brazilian government took in regulating the oil industry and what special role the mixed state-private organisation of Petrobras plays in influencing the competitiveness of the oil sector. The potential for such learning when cross-border deals are being considered is the principal focus of this research.

Dye and Sridhar assume that information is widely dispersed, so management find it hard to collect it all themselves. Given the collection problems, management may choose to consult investors who hold information which is difficult to come by. Rather than simply asserting that such dispersion exists, we consider the institutional reasons for its existence in certain settings and not in others. The principal reason which we propose here for the existence of dispersion is based on the notion of country-level relative diversity in M&A maturity. That is, we suggest

[9]Recorded on numerous press wires at the time, including Canada's *Financial Post* (*National Post*) on 14 November 2000, 'Hewlett shelves PWC deal' by David Akin with files from Simon Avery.

that dispersion may be relatively low in cross-border deals between similarly mature M&A markets (e.g., US to UK), whereas when there is divergence in maturity (e.g., US to India), there may be high dispersion of information. To summarise, we assume that the potential value to management of informed investors is greatest when the M&A maturity in the target region is low. In order to provide support for the assumption that informed investors are likely to hold valuable dispersed information and to explain how to identify such investors, it is necessary to review the literature on financial geography briefly.

The earlier research in this area concentrated on how certain investors try to build up proprietary 'local' information expertise. For instance, Huberman (2001) looks at regional Bell-operated companies and shows that investors tended to prefer to invest in local Bell firms rather than those in other regions and, in a similar fashion, Coval and Moskowitz (2001) find that US institutional investors exhibit a strong preference for locally headquartered firms in their domestic portfolios. More recently, Uysal et al. (2008) examine the impact of geographical proximity on the acquisition decisions of US companies and find that "acquirer returns in local transactions were more than twice that in non-local transactions." Bae et al. (2008) suggest that local analysts have a significant informational advantage over foreign analysts, basing this conclusion on data collected from a large sample of countries. They argue that a plausible explanation for their ability to identify a local advantage "is that local analysts have better access to information because they can talk to firm representatives in person and observe what goes on in firms directly." Thus, their research suggests that some institutional investors may be characterised as collecting and processing local information which is difficult or costly to access. This then begs the question of how to identify institutional investors who develop local expertise.

In an attempt to answer this question, Chen, Harford and Li (2007) argue that it is a mistake to view all institutional investors as having common information sets and processing ability. They argue that all institutional investors "face a cost-benefit analysis of monitoring versus trading, where monitoring includes both information gathering and efforts to influence management. Monitoring is distinguished from trading by both the type of information gathered (long-term versus short-term) and the effort to influence management rather than to simply trade on that information." They define a class of institutional investors which they describe as specialist monitors who invest significant resources in understanding the complex business environment of the firms in which they invest. They argue that those investors are characterised as conducting 'deep research' and, furthermore, that they typically invest for the long term. In addition, they posit that such investors can be identified by looking at portfolio turnover styles. Thus, we identify the informed investors most likely to collect local (regional) information as those investors who have a low portfolio turnover style.

To summarise the above, the literature on financial geography suggests that investors may earn higher returns if they collect complex local information. Dye and Sridhar's work suggests that this is exactly the sort of information which management may need to access when it is making investment decisions with dispersed information. We suggest that a specific application of these generic issues arises in the field of cross-border M&A deals. When the relative maturity of the M&A market of the potential target is significantly lower than that of the potential acquirer, the management of the acquirer may not have sufficient information on the target region, so, in order to increase the chance of a successful deal, it will want to collect information which is held in diverse places. In such a setting, informed investors with regional

expertise may have a role to play in releasing difficult-to-collect dispersed information. This leads to our two primary hypotheses:

H1: The Positive Effect of Regionally-Informed Investors on Deal Performance

Medium- to long-term post-M&A performance is positively related to the level of expertise that the acquirer's investors possess in the target region.

H2: The Effect of Market Diversity on the Importance of Regionally-Informed Investors

The effect of regionally-informed investors on post-M&A performance depends on the divergence between the acquirer and the target markets.

In order to test the relative success of various cross-regional deals, we adopt the standard approach of using medium- to long-term buy-and-hold abnormal returns following the announcement of an M&A deal. Thus, we estimate the following equation for acquirer ex-post performance:

$$BHAR\_Ret_{i,j} = \alpha + \beta_{H1} * KnI\_II_{i,j} + \beta_{H2} * (KnI\_II_{i,j} * Rel\_Maturity_{Acq.-Tar.\,j}) + \beta_k * (\text{Control variables}) + \varepsilon_{i,j} \quad (1)$$

where:

$BHAR\_Ret_{i,j}$ = the buy-and-hold abnormal returns (BHAR) which accrue to acquirers' low and very low turnover shareholder $_i$ from deal $_j$ over a 13-month event window starting from one month prior to announcement, to capture the run-up period, and ending 12 months after the announcement.

$KnI\_II_{i,j}$ = the percentage of the total portfolio of the low and very low turnover shareholder $_i$, holding shares in the acquirer of deal $_j$, which is invested in the region of the target company for deal $_j$.

$Rel\_Maturity_{Acq.-Tar\,j}$ = the difference in M&A maturity between the acquirer and target countries for deal $_j$.

To summarise, in order to confirm the hypotheses, the empirical tests need to show that the data is consistent with

$$\beta_{H1} > 0 \quad \text{and}$$

$$\beta_{H2} > 0$$

We use the following standard control variables which are found to be relevant to post-merger performance in the literature on mergers and acquisitions:

Acquirer borrowing capacity: Bruner (1988) shows that when bidders with high levels of debt capacity and liquidity buy targets with the opposite characteristics, this results in positive combined (acquirer and target) returns. We use the ratio of total debt to total assets of the bidder in order to estimate the debt capacity of bidder companies. We expect that the coefficient corresponding to this variable will be negative and significant. The results presented in Table 2.4.1-A (models 1 and 2) demonstrate that this variable is negatively and significantly related to the post-merger performance of the bidder.

Deal hostility: Mitchell and Stafford (2000), Cosh and Guest (2001), Fuller, Netter and Stegemoller (2002) and Megginson, Morgan and Nail (2004) document that hostile bidders tend to outperform non-hostile acquirers. We account for this effect by including a dummy variable which is equal to one in the cases of hostile takeovers. Interestingly, the results presented in Table 2.4.1-A (all models) show that this variable has a negative and significant effect on post-M&A performance.

Growth versus value bidders: So-called 'glamour' acquirers, i.e. companies with high market-to-book ratios, are more likely to overestimate their ability to perform a successful M&A deal as compared to value acquirers, i.e. companies with low market-to-book ratios. We expect the block shareholders, CEOs and directors of value bidders to be more prudent. As a result, the market should view value bidders more favourably than glamour bidders. This hypothesis is supported by Rau and Vermaelen (1998). In addition, Devos, Kadapakkam and Krishnamurthy (2008), as well as Bouwman, Fuller and Nain (2009), show that bidders with low market-to-book ratios tend to perform better than glamour acquirers. We expect that there is a negative association between the acquirer market-to-book ratio and post-M&A performance, and the results presented in Table 2.4.1-A (all models) confirm our expectation.

Industry relatedness: Moeller and Schlingemann (2005) and Martynova and Renneboog (2006) document that a high level of industry relatedness between the target and bidder can positively affect the post-M&A performance of bidders and vice versa. We use a dummy variable which captures the four-digit SIC (Standard Industry Classification) code relatedness between the target and bidder companies. In accordance with previous studies on post-deal performance and our a priori expectation, the four-digit SIC relatedness variable has a positive and significant coefficient (see Table 2.4.1-A, all models).

Method of payment: Managers who view their companies as undervalued by the capital market prefer to finance acquisitions with cash, whereas those who view their company as overvalued are more likely to finance M&A deals with stock (Kang and Stulz, 1997). Previous studies show that cash-financed acquisitions tend to be more beneficial, or at least less harmful, to bidder companies' shareholders (e.g., Huang and Walkling, 1987; Travlos, 1987; Loughran and Vijh, 1997; and Carow, Heron and Saxton, 2004). We account for the latter effect by including a dummy variable which equals one when the method of payment for the acquisition is all cash and zero otherwise. In line with our a priori expectation, this variable has a positive and significant coefficient in Table 2.4.1-A (all models).

Acquirer liquidity: According Martynova and Renneboog (2006), acquirers characterised by high liquidity levels experience worse post-M&A performance. We use the ratio of cash and cash equivalents to total assets in order to capture the influence of this variable. We expect that the level of acquirer liquidity will exert a negative and significant impact on post-

deal performance in our model. In line with previous studies and our a priori expectation, the regression results presented in Table 2.4.1-A (all models) show that the level of acquirer liquidity is negatively and significantly related to post-acquisition performance.

Acquirer share turnover: We expect that when the degree of information asymmetry between the bidder company's management and its shareholders is higher, the long-term post-M&A performance of bidders will be poorer. Following Ferreira et al. (2009), we account for this effect by measuring the share turnover of bidders prior to the announcement of a deal. We expect this variable to be positively and significantly associated with our measure of post-M&A performance. The results presented in Table 2.4.1-A (models 2, 3 and 4) show that acquirer share turnover has a negative and statistically significant coefficient.

Difference between acquirer and target countries' corporate governance: Martynova and Renneboog (2009) developed the so-called 'positive spill-over by law' hypothesis, which posits that the corporate governance regulations of the bidder are imposed on the target in M&A deals in which the acquirer is domiciled in a country with strong shareholder protection. Danbolt and Maciver (2012) provide empirical evidence in support of the positive spill-over by law hypothesis by demonstrating that the acquisition gains that accrue to target companies are significantly larger in cases when the acquirer's country of domicile is characterised by a superior governance system. This can have a positive impact on the post-M&A returns which accrue to bidder companies. To account for the latter effect, we calculate the difference between the acquirer and target countries' anti-self-dealing indices. We expect this variable to have a positive and significant association with post-M&A bidder performance and that the higher the divergence between target and bidder shareholder protection, the more likely it is that synergies will be realised by strengthening the target company's corporate governance. According to the results presented in Table 2.4.1-A (models 1, 2 and 3), this variable has a positive and significant coefficient.

Cultural difference between acquirer and target countries: We expect that acquirers can experience relatively poorer post M&A performance in cases when the cultural gap between the acquirer and target countries is relatively higher. This effect arises from difficulties in performing post-merger integration successfully when the cultural divergence makes integration a time consuming, difficult, and expensive process. In line with the results documented by Conn, Cosh, Guest and Hughes (2005), we provide empirical evidence in favour of this hypothesis (Table 2.4.1-A, models 3 and 4).

We present all variables in Table 2.2-A.

Table 2.2-A: Variable definitions

Number	Variable name	Definition	Expected sign
1	$BHAR\_Ret_{i,j}$	The buy-and-hold abnormal returns (BHAR) which accrue to acquirers' low and very low turnover shareholder $_i$ from deal $_j$ measured over a 12-month event window starting one month prior to announcement in order to capture the run-up period.	***

2	KnI_II	Investor regional expertise: the percentage of the total portfolio of the acquirer's low and very low turnover shareholders which is invested in the region of the target company. Note that for the purposes of performing the analysis at the deal level, this variable is defined as the number of all low and very low turnover institutional investors that have any portfolio holding in the region of the target.	+
3	Rel_Maturity	Relative maturity: the difference between the M&A maturity of the acquirer and target countries. M&A maturity is measured by the M&A Maturity Index, which rates 148 countries in terms of their degree of development for M&A purposes. The country index is calculated by using an average weighting of six groups of factors which have been identified in previous research as critical for a market to attract and sustain M&A activity, namely, regulatory and political, financial and economic, technological, socio-economic, development of physical infrastructure and availability of assets.	+/-
4	KnI_II x Rel_Maturity	Knowledge-intensive institutional investors *interacted with* relative maturity: this variable captures the effect of knowledge-intensive institutional investors as determined by the M&A maturity gap between the acquirer and target countries. It is expected that in cases where the target country is less mature for M&A purposes than the acquirer country, the effect of knowledge-intensive institutional investors on post-M&A performance should be more positive.	+
5	Prct_Held_B	Percentage held before the deal announcement: the percentage of outstanding bidder company shares that the low and/or very low turnover investor $_i$ holds in acquirer $_j$ measured three months prior to the announcement of the deal.	+/-
6	Cult_Dist	The cultural distance between the acquirer and target countries.	-
7	Deal_Val	Value of M&A deal: the natural logarithm of the M&A deal value measured in millions of US dollars.	-
8	Hostile	Hostile deal dummy: variable which is equal to 1 if the deal is hostile and 0 otherwise.	+
9	Ind_Relat.	Industry relatedness between target and acquirer dummy: variable which is equal to 1 if the target and acquirer four-digit SIC (Standard Industry Classification) codes are the same and 0 otherwise.	+
10	All_Cash	Method of payment is all-cash dummy: variable which is equal to 1 if the method of payment for the M&A deal is all cash and 0 otherwise.	+
11	$MV\_BV_{Acq\ Y-1}$	Market-to-book ratio of the acquirer company: equal to the market value divided by the book value of the acquirer one year before the announcement of the deal.	+/-

Number	Variable name	Definition	Expected sign
12	$TD\_TA_{Acq\ Y-1}$	Ratio of total debt to total assets of the acquirer company: equal to the total debt divided by the total assets of the acquirer company one year before the announcement of the deal.	+/-
13	$Liquid_{Acq\ Y-1}$	Liquidity of acquirer company: equal to the cash and cash equivalents divided by the total assets of the acquirer one year before the announcement of the deal.	-
14	$Turnov_{Acq}$	Share turnover of acquirer company: equal to the trading volume divided by the total outstanding shares of the acquirer company measured three months before the announcement of the deal.	-
15	$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	The difference between acquirer country and target country in the anti-self-dealing index: the anti-self-dealing index, as developed by Djankov, La Porta, Lopez-de-Silanes and Shleifer (2008).	+

16	Prior_Exp	Acquirer prior experience: equal to 1 when the acquirer has completed an earlier deal in the target region.	+
17	Top_Advis	Top advisor: equal 1 to when the acquirer is advised by a global investment bank.	**+**
18	Prior_Sub	Prior subsidiary: equal to 1 when the acquirer has a subsidiary in the target region.	+
19	Domic_Tar_Reg	Domiciled in the region of the target: equal to 1 when the institutional investor on the acquirer's share register is domiciled in the target region.	+
20	Prior_JV_or_Alliance	Prior joint venture or alliance: the natural logarithm of the number of joint ventures or strategic alliances that the acquirer had completed in the target region before the current deal.	+
21	Geog_Dist'	Geographic distance: the natural logarithm of the geographic distance between the acquirer and target region.	-
22	Tender_Offer	Tender offer: equal to 1 if the deal is classified as a 'tender offer' by the SDC Platinum Database and 0 otherwise.	+
23	Competing_Bidder	Competing bidder: equal to 1 if there are any competing bidders and 0 otherwise.	+/-
24	Target_Term_Fee	Target termination fee: equal to 1 if there is a target company termination fee clause in the deal agreement document and 0 otherwise.	+
25	Any_II_Leave	Any institutional investors which leaves: the number of institutional investors that dispose of their holdings in the acquirer company within six months of the announcement of the M&A deal.	-

Number	Variable name	Definition	Expected sign
26	Acquisitive_Cross-Border_Mean'	Acquisitive company in terms of average cross border deals: equal to 1 when the number of international deals which the acquirer has completed is greater than the average number of international deals completed.	+/-
27	Investor name	The name of the low and very low turnover investor that is present on the acquirer's share register.	****
28	DV_MV_{Acq}	Ratio of deal value to market value: equal to the M&A transaction value divided by the market value of the acquirer 20 days prior to the announcement of the deal.	*
29	$MV_{Acq\ Y-1}$	The market value of the acquirer one year prior to the announcement of the deal, measured in thousands of US dollars.	*
30	$Sales_{Acq\ Y-1}$	The net sales/revenue of the acquirer one year prior to the announcement of the deal, measured in thousands of US dollars.	*
31	$ROE_{Acq\ Y-1}$	Acquirer return on equity: acquirer net income divided by common shareholder's equity one year prior to the announcement of the deal.	*
32	$EBIT\_MG_{Acq\ Y-1}$	Acquirer EBIT margin: equal to earnings before interest and tax divided by net sales one year prior to the announcement of the deal.	*
33	$ICR_{Acq\ Y-1}$	Acquirer interest cover ratio: equal to earnings before interest and tax divided by the net interest expense of the acquirer one year prior to the announcement of the deal.	*

******* Please note that this is the dependent variable in our model.

** Please note that this variable is used to control for cluster effects.

* Please note that these variables are used to compare the characteristics of our final study sample to the sample of M&A deals which are excluded from this study.

2.3. Data and methodology

Following the approach of FMM, we merge a sample of cross-border M&A deals from SDC Platinum with the FactSet Lionshares Global Ownership database in order to obtain firm-level institutional ownership as of the quarter-end prior to deal announcement. In contrast to FMM, our sample consists of completed bids only as we are interested in testing the relationship between knowledge-intensive investors' levels of regional expertise and ex-post success – measured here as medium- to long-term shareholder wealth creation.[10] Next, we record the Factset region for the deals. Our final sample includes only public acquirers.
The data capture period is 1 January 2002 to 31 December 2011, and the resulting sample breaks down as follows:

1. Potential cross-border deals from SDC 8,254

2. M&A deals from 1 in which the acquirer has a share register in Factset 4,688

3. Completed deals in 2 with acquirer share price data from $_{t-1}$ to $_{t+12\ months}$ 3,932

4. Completed deals in 3 with all information for regression analysis available 2,065

5. Completed deals in 3 including primary index-listed acquirers 1,236

6. Completed deals in 5 with all information for regression analysis available 748

Table 2.3-A records the sample descriptive statistics for the deal data.

Table 2.3-A: Cross-border acquirers and transaction characteristics

							T			
Sample	All (2,065) - A		Study-sample (748) - B		Excluded (1,317) - C		Mean test (A-B)	Median test (A-B)	Mean test (C-B)	Median test (C-B)
Variable	Aver-age	Me-dian	Aver-age	Me-dian	Aver-age	Me-dian	t-stat.	Pearson Chi^2	t-stat.	Pearson Chi^2
Deal_val	495***	59***	1086	257	282***	36***	-8.92	258.91	-13.59	421.78
DV_MV	59%	5%***	10%	2%	77.05 %*	6%***	1.19	95.11	0.01	163.53
$MV_{Acq\ Y-1}$	9,416,841***	1,105,015***	21,550,815	8,807,284	4,770,547***	485,998***	-12.46	458.65	-18.97	770.07
$MV\_BV_{Acq\ Y-1}$	2.17	2.02**	3.05	2.22	1.83	1.96***	-0.61	5.51	-0.72	10.6
$Sales_{Acq\ Y-1}$	8,551,202***	766,706***	19,844,048	7,046,057	4,369,264***	295,973***	-12.23	474.47	-18.20	793.47
$ROE_{Acq\ Y-1}$	5.32%**	13%***	15.87 %	16%	1.27%***	11%***	-2.29	43.69	-2.71	78.09
$EBIT\_MG_{Acq\ Y-1}$	-84.24 %*	11%***	12%	13%	-122.85 %**	10%***	-1.58	22.17	-1.87	38.9

[10] Following a review of the acquirers' share registers of the initial data sample of 3,932 cross-border deals, we further refine the sample to include only deals by acquirers which make out the constituency of the primary stock market index [primary index-listed acquirers], e.g. including firms listed on the FTSE 100 and excluding firms listed on, for example, AIM. We introduce this filter to the dataset as the initial dataset of acquirers display some anomalies related to the type of investor on the share registers. For example, we find an unusually low proportion of index-tracking investors in smaller stocks and an unusually high proportion of value investors in the initial data cut. It should be noted that we have tested for any potential bias that could be introduced to our analysis by the imposition of the additional data filter. Please refer to the Robustness tests section of this paper for further details.

$TD\_TA_{Acq\ Y-1}$	23%	20%***	25%	23%	22%	17%***	-0.96	24.99	-1.14	47.24
$Liquid_{Acq\ Y-1}$	18.84%***	12%***	12%	7%	20.99%***	14%***	9.5	61.26	11.68	96.31
$ICR_{Acq\ Y-1}$	37.31***	5.84***	28.04	6.12	41.17***	5.61***	-6.53	373.99	-9.67	582.33

This table compares the key acquirer and deal characteristics of the study sample to the initial sample with all of the available information (i.e. including primary index-listed acquirers) and to the sample of excluded acquirers. 'All (2,065) - A' refers to the sample of all public acquirers for which accounting and share register information is available and which are also listed on non-primary exchanges. 'Study-sample (748) - B' refers to the final sample of deals used for the purposes of the analysis performed in this study. 'Excluded (1,317) -C' refers to the sample of deals which are excluded from the analysis due to the fact that they are not listed on a primary stock exchange index. Company financials are obtained from Datastream and measured in US$ while deal value is measured in millions of US$. 'Deal_val' stands for the value of the M&A transaction; 'DV_MV' is measured as the ratio of the M&A deal value to the acquirer market value as of 20 days before the announcement of the deal; '$MV_{Acq\ Y-1}$' stands for the market value of the acquirer as of one year prior to the announcement of the deal; '$MV_BV_{Acq\ Y-1}$' measures the acquirer market-to-book ratio as of one year prior to the announcement of the deal; '$Sales_{Acquirer\ Y-1}$' measures the acquirer net sales as of one year prior to the announcement of the deal; 'ROE' is measured in % terms and represents net income before preferred dividends less the preferred dividend requirement divided by last year's common equity, and is calculated by Datastream; '$EBIT_MG_{Acq\ Y-1}$' is measured as the ratio of EBIT to net sales as of one year before the announcement of the deal; '$TD_TA_{Acq\ Y-1}$' is measured as total debt divided by total assets; '$Liquid_{Acq\ Y-1}$' is measured as the ratio of acquirer cash and equivalents divided by total assets as of one year prior to the announcement of the deal; and '$ICR_{Acq\ Y-1}$' is measured as the ratio of acquirer EBIT divided by net interest expense as of one year prior to the announcement of the deal.
***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

Table 2.3-A shows a breakdown of the acquirer and deal characteristics for the final study sample and the acquirers which are excluded as they are not primary index-listed (see step 5 above). As expected, the final sample displays the characteristics of a mature company sample. Specifically, the sample firms are larger in terms of revenue (a median revenue of $7.046bn compared to $296m) and market value (a median revenue of $8.807bn compared to $486m), than the excluded sample. The firms in the final sample are also more profitable than the excluded, less mature firms, with the median return on equity for the former being 16% and the latter 11% in the year prior to the announcement of the deal.

We present the cross-regional deal distribution using the full set of deals including primary index-listed acquirers (step 5 above) from acquirer region to target region in Table 2.3-B, Panels A and B.

Table 2.3-B: M&A deals and investor expertise per sample region

Panel A: Number of completed cross-border deals per regional pair

Target region → Acquirer region ↓	Africa	Asia	Europe	Latin America	Middle East	North America	Pacific	All
Africa	4	0	9	5	1	3	6	28
Asia	0	74	52	2	1	43	14	186
Europe	18	43	351	45	8	158	16	639
Latin America	2	0	0	3	0	12	0	17
Middle East	0	6	2	0	3	12	0	23
North America	4	25	120	19	9	67	22	266
Pacific	2	12	24	2	0	21	16	77
All	30	160	558	76	22	316	74	1,236

Panel A shows the cross-border deal flow (number) in the sample from the acquirer region to the target region over the sample period (1,236 in total from all regions to all regions).

Panel B: Proportion of completed cross-border deals per regional pair

Target region → Acquirer region ↓	Africa	Asia	Europe	Latin America	Middle East	North America	Pacific	All
Africa	0.14	0.00	0.32	0.18	0.04	0.11	0.21	1.00
Asia	0.00	0.40	0.28	0.01	0.01	0.23	0.08	1.00
Europe	0.03	0.07	0.55	0.07	0.01	0.25	0.03	1.00
Latin America	0.12	0.00	0.00	0.18	0.00	0.71	0.00	1.00
Middle East	0.00	0.26	0.09	0.00	0.13	0.52	0.00	1.00
North America	0.01	0.09	0.45	0.07	0.03	0.25	0.08	1.00
Pacific	0.03	0.16	0.31	0.03	0.00	0.27	0.21	1.00

Panel B shows the proportion of cross-border deal flow in the sample from the acquirer region to the target region over the sample period (1,236 in total from all regions to all regions).

Panel C: Average investor regional expertise (KnI_II)

Target region → Acquirer region ↓	Africa (1)	Asia (2)	Europe (3)	Latin America (4)	Middle East (5)	North America (6)	Pacific (7)	Av. KnI_II (8)	Av. KnI_II (cross-regional) (9)
Africa	0.28	-	0.34	0.03	-	0.30	0.03	0.19	0.19
Asia	-	0.24	0.34	0.01	0.00	0.36	0.01	0.30	0.32
Europe	0.01	0.11	0.48	0.01	0.02	0.28	0.02	0.35	0.22
Latin America	0.00	-	-	0.12	-	0.32	-	0.28	0.31
Middle East	-	0.11	0.32	-	0.33	0.44	-	0.21	0.21
North America	0.02	0.07	0.18	0.01	0.00	0.64	0.01	0.26	0.16
Pacific	-	0.21	0.28	0.01	-	0.32	0.05	0.24	0.28

Panel C illustrates the average level of expertise in the target region which acquirers have on their share registers pre-announcement. Specifically, it shows the average portfolio allocation in the target region of the low and very low turnover investors on the acquirer share register in the quarter prior to the announcement of the deal, i.e. our definition of knowledge-intensive institutional investors' regional expertise (*KnI_II*). Note that the turnover classification is defined by the FactSet database and the average level of expertise is the equally weighted average for all low and very low turnover investors which are registered holder of the acquirers shares - for our sample of 1,236 completed deals – in the period reaching two quarters prior to the announcement. Columns 1 to 7 show the average expertise per regional pair, e.g. the value of 0.28 in the upper left cell shows that the level of regional expertise of African acquirers in our sample, i.e. the average portfolio allocation for low and very low turnover investor listed on the acquirer share register into the Africa region, is 28%. If we compare this to the cell corresponding to African acquirers investing in the European region, we can conclude that the level of expertise on the acquirers' share register (34%) is on average higher than for their home region of Africa. The final two columns show the average regional expertise shown ex-ante on acquirers' share registers per acquirer region but irrespective of target region. So, if we compare the top two listed acquirer regions, Africa and Asia, we see that Asian acquirers have on average more regional expertise – and should, therefore, be in a better position to evaluate investment opportunities abroad providing that their management teams consult their knowledge-intensive investors – on their share registers compared to African acquirers. Finally, the last column takes the same average irrespective of target region but excludes intra-regional transactions.

We present the descriptive statistics in three ways. Panel A shows a *numerical count* of the regional deals. The within region deals are recorded on the diagonal and all other entries represent cross-regional deals. It is not surprising to see that the largest number of cross-regional deals is from Europe to North America, followed by North America to Europe. Interestingly, the next highest cross-regional deal counts are for Asia to Europe and Asia to North America. The sum of these two-cross border counts in which the acquirer is Asian is actually greater than the deal count for within the Asian region.

One problem with this type of count is that some regions are much larger than others, so Panel B presents the same deal data but in *proportionate terms* to avoid the possibility of relative regional trends being masked by focusing on a simple numerical count. The proportions show some interesting features for the smaller regions. African acquirers complete 32% of all their deals with European targets compared to 14% within the region itself and only 11% with North America. In contrast, Latin American acquirers do 71% of all their deals with North American targets, only 18% are within region and the percentage with European targets is negligible. The other region which shows a clear pattern is the petro-dollar rich region of the Middle East where acquirers have 52% of targets in North America, 26% in Asia and a surprisingly low proportion of European targets of 9%.

While these first two panels help to develop an appreciation of regional M&A geography, they do not provide any information on our key proposed explanatory variable of investor expertise. The next step is to analyse the final sample of cross-border acquirers' share registers in order to construct the regional expertise variable. We identify the knowledge-intensive (informed) investor subset by selecting all of the institutional investors classified by FactSet as having a low or very low portfolio turnover.[11]

We then record the regional investment pattern for this large sub-sample of investors. So, for instance, for illustrative purposes consider an acquirer based in Europe. Step 1 records all of the investors on the acquirer's share register with a low or very low turnover investment style. Step 2 then records the cross-regional distribution of all the investments of each of these informed investors. Thus, when a US acquirer is considering a cross-regional M&A deal into Latin America, it is possible to identify how many of its institutional investors already have holdings in Latin America and how much larger that holding is – implying that a larger proportion indicates a higher level of expertise. Specifically, our measure of foreign expertise is the percentage of each investor's portfolio (measured by market capitalisation) which is invested in the target region. If the deal is US (acquirer region: North America) to Brazil (target region: Latin America), we look at all of the investors which are on the US acquirer's share register. For each investor, we have the data of their regional investment, i.e. the proportion of their portfolio which is invested in each global region (North America, Europe, Latin America, Asia, the Pacific and the Middle East). In this example, the foreign expertise for each investor would be the percentage of market value which is held in the Latin America region vs. the total for all regions. We use these target region holdings as the measure (proxy) for regional expertise given that it is unlikely that the investors will have invested in the target region without first conducting research and collecting data. In order to see the patterns of regional expertise, Panel C presents the average level of expertise on acquirers' share registers, i.e. the average portfolio allocation which informed investors ('Low' and 'Very Low') hold in the target region.

Panel C, Columns 1 to 7, show the average expertise per regional pair. As an example, we find that for African acquirers which invest in Europe, the average regional expertise on their share register is 34% compared to 30% for investing in North America.The final two columns present the average regional expertise measured ex-ante on acquirers' share registers per

[11] FactSet classifies investors on the basis of their portfolio turnover style in five categories: very high, high, medium, low and very low. It also classifies an institution as low turnover if it has a two- to four-year holding period and its portfolio has an annual turnover of 25% to 50%. An institution is classified as very low turnover if it has a holding period of four years or longer and its portfolio has an annual turnover of less than 25%. Portfolio turnover is calculated by dividing the average value of transactions (as reported) by the market value of the portfolio.

acquirer region but irrespective of target region. If we compare the top two listed acquirer regions, Africa and Asia, we see that Asian acquirers have on average more regional expertise. Therefore, Asian acquirers should be in a better position to evaluate investment opportunities abroad as compared to African acquirers, providing that their management teams consult the knowledge-intensive investors on their share registers. Finally, the last column takes the same average irrespective of target region but excludes intra-regional transactions. From this table, we conclude that European and Asian acquirers appear to have the highest level of knowledge-intensive expertise on their share registers when making cross-border deals. The average portfolio allocation in the target region for knowledge-intensive investors on the acquirer share register for European acquirers is 35% with the corresponding allocation for Asian acquirers' investors being 30%. However, these figures do not address the issue of the large flow of intra-regional cross-border transactions for which we assume the level of investor expertise is less relevant. The average knowledge-intensive regional expertise for cross-regional deals is presented in Column 9 of the same panel. Here we can see that it is instead Asian (32%), Latin American (31%) and Pacific (28%) acquirers which have the highest level of expertise in the target region represented on their share registers.

In addition to the regional expertise of investors, the other explanatory variable, which we introduce as a proxy for market divergence, is the difference in the maturity for M&A purposes of the acquirer and target regions. We capture this by using the M&A Maturity Index developed by Appadu, Faelten, Moeller and Vitkova (2012). This index is based on a country scoring procedure which evaluates the factors that make a country attractive for and able to sustain M&A activity. More specifically, the M&A maturity index is based on five main groups of factors which have been identified by previous studies as the major drivers of M&A activity. These five factor groups are:

- Regulatory and political factors (e.g., rule of law (see Rossi and Volpin, 2004) and corruption of officials (see Yartey, 2008));
- Economic and financial factors (e.g., GDP growth (see Berthelemy and Demurger, 2000 and Liu, Shu and Sinclair, 2009) and stock market capitalisation and access to financing (see Yartey, 2008 and Saborowski, 2009));
- Technological factors (e.g., high-technology export and innovation (see Porter, 1993));
- Socio-economic factors (e.g., population and demographics (Appadu, Faelten, Moeller and Vitkova (2012)); and
- Quality of infra-structure and assets (e.g. roads and railways, and the number of sizeable corporate assets (see, e.g., Sekkat and Veganzones-Varoudakis, 2004; Quazi, 2011; Mateev, 2009 and Anyanwu, 2012)).

The M&A Maturity Index allocates a score of between 0% and 100% for each factor group to 148 countries worldwide – where 100% indicates the highest degree of development for M&A purposes and 0% the lowest level – and produces an overall M&A maturity score as a weighted average of the five groups. The top and bottom 15 countries represented in our sample are shown in Table 2.3-C, Panels A and B.

Table 2.3-C: Description of the M&A Maturity Index

Panel A: M&A Maturity Index country ranking and index score (2012), corresponding score for the five factor groups for the top 15 ranked countries represented in the sample

Country name	Rank	M&A Maturity Index score	Regulatory and political	Economic and financial	Technological	Socio-economic	Infrastructure and assets
United States	1	0.85	0.84	0.81	0.92	0.80	0.89
Singapore	2	0.84	0.96	0.75	0.90	0.68	0.92
United Kingdom	3	0.82	0.80	0.77	0.93	0.71	0.90
Hong Kong	4	0.81	0.87	0.76	0.83	0.72	0.88
South Korea	5	0.81	0.76	0.65	0.95	0.91	0.78
Germany	6	0.80	0.76	0.66	0.91	0.73	0.95
Canada	7	0.80	0.84	0.76	0.89	0.81	0.71
France	8	0.80	0.80	0.70	0.92	0.67	0.90
China	9	0.79	0.44	0.87	0.81	0.97	0.87
Japan	10	0.79	0.73	0.75	0.92	0.69	0.87
Netherlands	11	0.79	0.86	0.71	0.94	0.65	0.79
Switzerland	12	0.79	0.86	0.75	0.93	0.60	0.78
Australia	13	0.77	0.90	0.73	0.85	0.69	0.70
Spain	14	0.77	0.68	0.74	0.76	0.79	0.90
Austria	15	0.74	0.80	0.58	0.84	0.60	0.88

Panel B: M&A Maturity Index country ranking and index score (2012), corresponding score for the five factor groups for the bottom 15 ranked countries represented in the sample.

Country name	Rank	M&A Maturity Index score	Regulatory and political	Economic and financial	Technological	Socio-economic	Infrastructure and assets
Egypt	65	0.56	0.38	0.54	0.47	0.66	0.74
Peru	68	0.55	0.52	0.64	0.56	0.59	0.43
Philippines	70	0.54	0.35	0.64	0.65	0.63	0.41
Lebanon	76	0.51	0.37	0.59	0.59	0.51	0.50
Macedonia	80	0.50	0.63	0.49	0.46	0.55	0.38
Pakistan	86	0.47	0.21	0.46	0.37	0.65	0.64
Bangladesh	90	0.44	0.20	0.61	0.32	0.69	0.39
Syria	97	0.42	0.38	0.45	0.35	0.49	0.42
Nigeria	101	0.41	0.23	0.50	0.40	0.53	0.38
Ecuador	102	0.40	0.27	0.37	0.49	0.52	0.36
Ghana	107	0.39	0.52	0.38	0.25	0.49	0.31
Papua New Guinea	123	0.34	0.26	0.50	0.40	0.35	0.19
Uganda	132	0.32	0.31	0.34	0.28	0.41	0.25
Sierra Leone	133	0.31	0.33	0.36	0.39	0.29	0.20
Dem. Rep. of Congo	143	0.27	0.19	0.39	0.42	0.25	0.12

Panels A and B shows the top and bottom 15 countries in the 2012 M&A Maturity Index represented in our sample. The *Rank* is the country ranking for 2012, based on the total of 148 countries ranked in the index. The *M&A Maturity Index score* – which determines the rank – is the weighted average of the five factor group scores including 1) *Regulatory and political factors* (e.g., rule of law and political stability), 2) *Economic and financial factors* (e.g., GDP growth and access to financing), 3) *Technological factors* (e.g., high-tech exports and innovation), 4) *Socio-economic factors* (e.g., population) and 5) *Quality of infra-structure and assets* (e.g. roads and railways, and the number of sizeable corporate assets).

The country rankings for 2012 demonstrate the emergence of Asia as a fast developing region for M&A activity, with the region claiming five of the top ten country positions. Despite the US (85%) and the UK (82%) claiming the top and third spots respectively, Singapore (84%) and Hong Kong (81%) are second and fourth respectively, with South Korea (5th), China (9th) and Japan (10th) following. By using the relative M&A maturity index score,[12] i.e. the difference between the acquirer and target countries' levels of development for M&A purposes, we should be in a better position to measure the true divergence between the two markets and, therefore, better identify the cross-border transactions for which management is in greater need of additional expertise. According to Tong, Alessandri, Reur and Chintakananda (2008), country- as opposed to industry-effects also influence the performance of companies involved in cross-country investment activities.

In Table 2.3-D, Panels A to B we present a univariate analysis of acquirer ex-post shareholder wealth creation.

Table 2.3-D: Long-term acquirer performance – Buy-and-hold returns (BHAR)

Panel A: Regional acquirer BHAR – time dependent

Acquirer region ↓	BHAR $_{t-1m\ to\ t+12m}$ t-stats (observations)	BHAR $_{t-1m\ to\ t+24m}$ t-stats (observations)	BHAR $_{t-1m\ to\ t+36m}$ t-stats (observations)
Africa	0.042	0.076	0.032
	0.616 (28)	0.461 (23)	0.104 (21)
Asia	0.108***	0.163***	0.295***
	4.883 (186)	4.961 (164)	5.675 (140)
Europe	0.053***	0.121***	0.215***
	5.061 (639)	6.729 (607)	7.144 (561)
Latin America	0.175**	0.198*	0.086
	2.257 (17)	1.928 (15)	0.729 (14)
Middle East	-0.105	-0.103	-0.151
	-1.318 (23)	-0.795 (19)	-0.910 (17)
North America	0.095***	0.236***	0.415***
	4.481 (266)	7.230 (243)	8.129 (209)
Pacific	0.109***	0.175***	0.392***
	2.969 (77)	3.184 (70)	4.709 (63)
All	0.072***	0.151***	0.266***
	8.499 (1,236)	11.567 (1,141)	12.826 (1,025)

[12] Note that the M&A Maturity Index is measured on a time series basis starting from the year 2006, before which we use data for 2006 as the latest available year.

Panel A shows the equally-weighted buy-and-hold portfolio returns (BHAR) for all acquirers which completed a cross-border deal during the sample period (1,236 deals). The matrix shows the performance per acquirer region and BHAR period, ranging from month -1, before the announcement, to months 12, 24 and 36 after the announcement. Each period shows the average abnormal total return, adjusted to the regional MSCI index and the corresponding t-statistics and number of observations. Note that for the Middle East and Africa – where no appropriate regionally defined indices for the sample period could be sourced – we use the MSCI Emerging Markets Europe and Middle East and the MSCI Emerging Markets Europe, Middle East and Africa indices, respectively.
***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

Panel B: Regional acquirer BHAR – target region dependent

Target region → Acquirer region ↓	Africa t-stats (obs.)	Asia t-stats (obs.)	Europe t-stats (obs.)	Latin Amer-ica t-stats (obs.)	Middle East t-stats (obs.)	North Amer-ica t-stats (obs.)	Pacific t-stats (obs.)
Africa	-0.02	-	0.15	0.11*	0.33	0.08	-0.20
	-0.17 (4)	- (0)	1.18 (9)	1.74 (5)	- (1)	1.14 (3)	-0.93 (6)
Asia	-	0.16***	0.05	0.04	0.00	0.11**	0.08**
	- (0)	3.46 (74)	1.30 (52)	0.25 (2)	- (1)	2.80 (43)	2.11 (14)
Europe	0.09	0.06	0.05***	0.00	0.09**	0.05***	0.04
	1.36 (18)	1.51 (43)	3.51 (351)	0.12 (45)	2.04 (8)	3.21 (158)	0.51 (16)
Latin America	0.26	-	-	0.17	-	0.16	-
	0.84 (2)	- (0)	- (0)	1.02 (3)	- (0)	1.64 (12)	- (0)
Middle East	-	0.14	-0.09	-	-0.37*	-0.16*	-
	- (0)	0.70 (6)	-0.50 (2)	- (0)	-1.83 (3)	-1.82 (12)	- (0)
North America	-0.12	0.15*	0.09**	0.17*	0.14*	0.09***	0.01
	-1.43 (4)	1.97 (25)	2.82 (120)	1.69 (19)	1.88 (9)	2.59 (67)	0.15 (22)
Pacific	0.09	-0.01	0.12*	0.17***	-	0.17**	0.10
	0.59 (2)	-0.06 (12)	1.74 (24)	4.39 (2)	- (0)	2.13 (21)	1.43 (16)

Panel B shows the equally-weighted buy-and-hold portfolio returns (BHAR) for all acquirers which completed a cross-border deal during the sample period (1,236 deals). The matrix shows the performance per acquirer and target region, with the BHAR period ranging from month -1, before the announcement, to month 12 after the announcement. Each cell shows the average abnormal total return, adjusted to the regional MSCI index and the corresponding t-statistics and number of observations. Note that for the Middle East and Africa – where no appropriate regionally defined indices for the sample period could be sourced – we use the MSCI Emerging Markets Europe and Middle East and the MSCI Emerging Markets Europe, Middle East and Africa indices, respectively.
***, **, and * indicate statistical significance at a 1%, 5% and 10% level, respectively.

The general form of equation (1) shows that we use post-acquisition returns as the dependent variable in order to appraise the performance of individual M&A deals. More specifically, since the main focus of our analysis is to examine post-M&A performance from the perspective of investors with low or very low turnover (informed investors), we argue here that the most relevant performance metric is the one which takes into account the post-acquisition returns over a 13-month investment horizon.[13] We thus measure performance on the basis of acquirer share price returns using the buy-and-hold abnormal returns (BHAR) which accrue to acquirers over a 13-month event window starting from one month prior to the announcement of the

[13] This investment horizon also coincides with the time period which Factset uses in order to distinguish between different levels of investor turnover.

deal in order to capture the run-up period to 12 months post the announcement of the deal.[14] The BHAR approach to measuring abnormal returns has been widely used in studies involving share price performance (see, e.g., Barber and Lyon, 1997 and Mitchell and Stafford, 2000). Mitchell and Stafford (2000) define BHAR as "the average multiyear return from a strategy of investing in all firms that complete an event and selling at the end of a pre-specified holding period versus a comparable strategy using otherwise similar non-event firms." An advantage of using BHAR is that this approach to measuring company share price performance is closer to investors' actual investment experience compared to the periodic rebalancing which other approaches to share price performance analysis involve. Given the specific cross-regional focus of this study, the BHARs are equally weighted and adjusted to the performance of the respective MSCI regional index of the acquirer company over the same period. Specifically, we consider the following regions for the purposes of calculating bidder BHAR: Africa, Asia, Europe, Latin America, the Middle East, North America and the Pacific.[15]

In Table 2.3-D, Panel A, we provide an overview of acquirers' BHAR across acquirer region and time. Our first conclusion is that, on average, acquirers appear to outperform their regional indices by 7.2% in the $_{t\text{-}1m\ to\ t+12m}$ period around the announcement of the transaction. This is an interesting finding as many previous studies provide evidence to the contrary, i.e. that M&A deals typically destroy shareholder wealth for the acquirer (Schlingemann, Stultz and Moeller, 2005). We explain this average positive acquirer return by the superior ex-ante financial performance displayed by our study sample due to their status as listed on the primary stock exchange index. Some interesting regional differences are also evident from the results presented. When measuring BHAR over the $_{t\text{-}1m\ to\ t+12m}$ period, we find that acquirers from Latin America earn the largest statistically significant returns while acquirers from Africa and the Middle East do not earn any positive returns which are statistically significantly different from zero. This aggregate average as well as the relative returns pattern does not seem to change qualitatively when the period over which the BHARs are calculated is increased from t_{+12} to t_{+24} or t_{+36} months.

Panel B presents the data on returns at a regional level. This shows a very different pattern to the aggregated statistics above. For instance, as mentioned earlier, Asian acquirers are relatively big investors in both Europe and North America and even though, when all deals are taken together, they earn positive returns overall (10.8% Panel A), they do not earn statistically significantly positive returns on their European deals. There appear, therefore, to be significant variations in cross-regional deal performance.

This naturally leads to formal testing in order to see whether the variations in performance can be explained by Hypotheses 1 and 2 – the role of investors with regional expertise when M&A markets are most divergent.

[14] Note that the BHAR analysis uses the total returns of a company, i.e. it includes share price appreciation or depreciation as well as the return from reinvesting the paid dividends.

[15] Note that for the Middle East and Africa – where no appropriately regionally defined indices could be sourced – we use the MSCI Emerging Markets Europe and Middle East and the MSCI Emerging Markets Europe, Middle East and Africa, respectively.

2.4. Empirical Analysis

2.4.1. Empirical tests on the effects of institutional investors' regional expertise

Our three-level dataset consists of 748 cross-border deals, and 4,078 unique institutional investors representing 75,555 unique observations of institutional investor foreign expertise. Therefore, the average number of institutional investors that are present on each acquirer's share register for a given deal is 101 (with a median of 7).[16] Given that our final sample consists of 4, 078 unique institutional investors, we conclude that there are approximately 18.5 unique shareholders involved in each of the 748 M&A deals.[17]

As our regressions are run at the institutional investor level (from the acquirer share register), we note that clustering issues might arise. It is certainly plausible that the same investor could be a shareholder in multiple acquirers in the sample, especially for acquirers in the same region. If two (or more) acquirers with the same investor(s) on their share register invest in the same region, the effect of our *KnI_II* variable on deal success might be overstated. We control for this issue by adding cluster controls on the Investor name in a panel regression setting. All regression models illustrated in Tables 6 through 12 control for this issue. Using the BHAR performance of bidders, adjusted to a size-specific index to control for the potential bias in our sample of primary index-listed acquirers being larger than the average firm, we test the relationship between the acquirers' post-merger performance over an event window of $_{t\text{-}1m\ to\ t+12m}$ and the degree of regional expertise of the acquirers' informed investors,[18] i.e. estimating Equation (1) with the results reported in Table 2.4.1-A.

Table 2.4.1-A: Analysis of t-1m to t+12m and t-1m to t+36m post-M&A performance

The dependent variable is the acquirer BHAR returns over the -1 to +12- and +36-months adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealingAcq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, and 'Rel_Maturity' is the difference between acquirer and target M&A maturity. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. To correct for the possibility that our coefficients are not estimated

[16] The substantial difference between the average and median number of investors registered on a given deal reflects the large difference between the maximum (956) and minimum (1) number of investors present on the acquirer's share register for a given deal.

[17] In order to capture these different methods of accounting for our sample, Tables 6 through 12 report the number of unique institutional investors, the number of M&A deals and the number of observations for each estimated regression.

[18] To control for any potential diminishing time effect, we test the same relationship over a longer time period, namely the acquirer BHAR over an event window of $_{t\text{-}1m\ to\ t+36m}$. Our conclusions are robust to this control, presented in Table 6, Models 3 and 4.

on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

	(1) Dependent variable: $_{t\text{-}1m\ to\ t+12m}$ BHAR	(2) Dependent variable: $_{t\text{-}1m\ to\ t+12m}$ BHAR	(3) Dependent variable: $_{t\text{-}1m\ to\ t+36m}$ BHAR	(4) Dependent variable: $_{t\text{-}1m\ to\ t+36m}$ BHAR
Institutional investor expertise				
Knl_II	**0.062***** 15.640	**0.053***** 13.200	**0.024***** 4.380	0.004 0.700
Knl_II x Rel_Maturity		**0.415***** 6.750		**1.698***** 10.340
Control variables				
Cult_Dist	**0.004***** 4.030	**0.003***** 2.920	**-0.019***** -10.150	**-0.022***** -10.350
Prct_Held_B	0.087 1.130	0.083 1.080	0.219 1.080	0.262 1.280
Deal_Val	**-0.022***** -24.880	**-0.021***** -23.580	**-0.058***** -35.900	**-0.059***** -35.540
Hostile	**-0.083***** -13.070	**-0.089***** -14.020	**-0.039***** -3.920	**-0.046***** -4.560
Ind_Relat.	**0.033***** 15.550	**0.027***** 12.810	**0.141***** 35.310	**0.141***** 34.510
All_Cash	**0.084***** 40.780	**0.076***** 37.700	**0.067***** 18.920	**0.078***** 21.630
$MV\_BV_{Acq\ Y\text{-}1}$	**0.000***** -20.590	**0.000***** -18.980	**-0.003***** -21.970	**-0.003***** -21.010
$TD\_TA_{Acq\ Y\text{-}1}$	**-0.015**** -2.440	**-0.022***** -3.490	**0.254***** 11.700	**0.252***** 11.670
$Liquid_{Acq\ Y\text{-}1}$	**-0.321***** -29.260	**-0.324***** -29.370	**-0.174***** -7.190	**-0.154***** -6.320
$Turnov_{Acq}$	**0.045***** 3.690	**-0.031**** -2.590	**-0.060**** -2.240	**-0.069**** -2.430
Anti-self-$dealing_{Acq\text{-}Tar}$	**0.036***** 9.660	**0.040***** 10.530	**0.029***** 4.130	0.001 0.110
Rel_Maturity		**-0.103***** -5.450		**0.113***** 4.060
Constant	**1.145***** 190.900	**1.161***** 192.470	**1.416***** 93.290	**1.404***** 89.700
Unique institutional investors	4,078	4,078	3,758	3,758
Cross-border M&A deals	748	748	697	697
Number of observations	75,555	75,555	64,945	64,945
Wald Chi^2	363.46	333.88	391.76	392.09

The results for $\beta_{H1} > 0$ indicate that there is a significant and positive relationship between the level of regional expertise that the acquirer's informed investors possess and post-bid performance. Specifically, models 1, 2 and 3 in Table 2.4.1-A show that the coefficient which corresponds to the variable that quantifies the regional expertise of each monitoring investor, namely *Knl_II*, is positive and statistically significantly different from zero. This latter result provides support for Hypothesis 1: that informed investors which possess specialised regional knowledge about the target's geographical region (acquired due to existing investments in the region) can contribute to the success of cross-regional M&A deals.

In addition, the regression results presented in Table 2.4.1-A, (models 2 and 4), provide support for the second hypothesis developed in this study: that $\beta_{H2} > 0$ is positive. Specifically, the models show that the regional expertise of knowledge-intensive institutional investors is

more useful (in the sense that it adds more value to subsequent acquirer performance) when the target country's M&A market is most divergent from the acquirer's home M&A market (as indicated by a positive and bigger difference in the M&A Maturity Index scores of the acquirer and target countries). Specifically, the coefficient on the interaction variable *KnI_II x Rel_Maturity* is positive and significant. Models 2 and 4 show that the expertise of informed investors is more important in cases where the 'distance' between the M&A maturity of the acquirer and target countries is wider.

As demonstrated by Table 2.4.1-A (model 2), the coefficient corresponding to the variable *KnI_II*, which measures the knowledge of the target region that each investor on the acquirer share register possesses, is equal to 0.053. The size of the coefficient indicates that for every percentage point increase in the investor's expertise (or for every percentage point increase in the proportion of the knowledge-intensive investor's portfolio that is invested in the target region), the $_{t\text{-}1m\ to\ t+12m}$ BHAR of the acquirer increases by 0.053 percentage points on average. Similarly, the coefficient corresponding to the variable *KnI_II x Rel_Maturity*, which measures the importance of knowledge of the target's M&A market for cases where acquirer's home M&A market is divergent from the target country's M&A market, is equal to 0.415. The size of the coefficient indicates that for every percentage point increase in the *product* of the investor's knowledge of the target region *and* the degree to which the acquirer's home M&A market is more developed than the target's (measured by the difference in M&A maturity scores between the acquirer and target countries), the $_{t\text{-}1m\ to\ t+12m}$ BHAR of the acquirer increases by 0.415 percentage points.

The fact that the regional expertise of the low and very low turnover investor class has a positive association with acquirers' post-merger performance is in accordance with the line of argument put forward by Chen et al. (2007), who argue that independent, long-term institutional investors gather information about the overall quality of firm management and its tendency to make better or worse decisions. Independent, long-term institutional investors also gather information about the scope of their influence over the actions of firm managers and invest in companies where the benefits associated with the quality of management and the opportunity to influence managerial decisions outweigh the costs of gathering information and monitoring the companies. Moreover, the finding that there is a positive association between the post-merger performance of bidders with the pre-acquisition holdings of institutional investors which possess specialised knowledge about the M&A market of the target's region demonstrates the idea that this class of informed investor is better positioned to gather information about individual investment projects such as cross-border deals.

2.4.2. Robustness tests

We conduct a bank of further tests to determine whether our principal result $\beta_{H2} > 0$ remains if we account for a number of additional factors that could be driving the regression results.

2.4.2.1. Alternative sources of regional expertise

First, we re-estimate our original models (presented in Table 2.4.1-A) by including a number of control variables that capture other potential sources of expertise about the target's M&A environment. We account for any previous acquisitions that the acquirer has completed in the

target region by including the dummy variable '*Prior Exp'*. The results, presented in Table 2.4.2.1-A, model 1, show that it loads with a significant positive coefficient, but does not affect the sign or significance of β_{H2}.

Table 2.4.2.1-A: Analysis of t-1m to t+12m post-M&A performance (Alternative sources of regional expertise

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period by the MSCI World Size Index corresponding to each acquirer company. 'Knl_Il' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'Knl_Il x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BVAcq' is the market-to-book ratio of the acquirer, 'TD_TAAcq' is the ratio of total debt to total assets, 'LiquidAcq' is the ratio of cash and cash equivalents to total assets, 'TurnovAcq' is the trading volume divided by total outstanding shares three months before the announcement of the deal, 'Anti-self-dealingAcq-Tar' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Prior_Exp' equals 1 when the acquirer completed an earlier deal in the target region, 'Top_Advis' equals 1 when the acquirer is advised by a global investment bank, 'Prior_Sub' equals 1 when the acquirer has a subsidiary in the target region, 'Domic_Tar_Reg' equals 1 when the institutional investor on the acquirer's share register is domiciled in the target region, and 'Rel_Maturity' is the difference between acquirer and target M&A maturity. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)
Institutional investor expertise					
Knl_II	**0.026*** **	**0.023*** **	**0.024*** **	**0.020*** **	**0.014*** **
	8.710	7.670	8.190	6.270	4.420
Knl_II x Rel_Maturity	**1.066*** **	**1.047*** **	**0.920*** **	**1.037*** **	**0.894*** **
	14.130	13.840	12.090	13.720	11.930
Control variables					
Cult_Dist	0.001	0.001	**0.001***	0.001	**0.002** **
	1.030	1.520	1.760	1.380	2.120
Prct_Held_B	0.022	0.026	0.027	0.013	0.036
	0.440	0.520	0.530	0.260	0.720
Deal_Val	**-0.013*** **	**-0.014*** **	**-0.016*** **	**-0.015*** **	**-0.014*** **
	-20.520	-26.280	-27.710	-26.770	-22.020
Hostile	**-0.087*** **	**-0.087*** **	**-0.080*** **	**-0.085*** **	**-0.084*** **
	-17.260	-16.890	-15.740	-16.590	-16.600
Ind_Relat.	**0.009*** **	**0.009*** **	**0.012*** **	**0.008*** **	**0.011*** **
	5.860	6.350	8.000	5.320	7.410
All_Cash	**0.068*** **	**0.069*** **	**0.069*** **	**0.069*** **	**0.069*** **
	46.640	47.510	47.100	47.080	47.600
$MV\_BV_{Acq\ Y-1}$	**0.000*** **	**0.000*** **	**0.000*** **	**0.000*** **	**0.000*** **
	-17.190	-16.020	-17.280	-19.150	-13.150
$TD\_TA_{Acq\ Y-1}$	**0.020*** **	0.008	-0.004	**0.019*** **	-0.002
	4.600	1.680	-0.720	4.470	-0.410
$Liquid_{Acq\ Y-1}$	**-0.220*** **	**-0.228*** **	**-0.238*** **	**-0.223*** **	**-0.235*** **
	-30.080	-29.930	-31.060	-30.510	-29.830
$Turnov_{Acq}$	**-0.077*** **	**-0.080*** **	**-0.068*** **	**-0.083*** **	**-0.066*** **
	-11.800	-12.340	-10.350	-12.700	-9.920
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**0.022*** **	**0.019*** **	**0.029*** **	**0.022*** **	**0.025*** **
	7.980	7.050	10.350	8.190	9.000
Prior_Exp	**0.000*** **				**0.000*** **
	17.250				16.740
Top_Advis		**-0.010*** **			**-0.010*** **
		-6.650			-6.460
Prior_Sub			**0.013*** **		**0.007*** **
			6.620		3.570
Domic_Tar_Reg				**0.016*** **	**0.015*** **
				8.780	8.130
Rel_Maturity	**-0.059*** **	**-0.047*** **	**-0.069*** **	**-0.038*** **	**-0.039*** **
	-4.650	-3.660	-5.350	-2.880	-2.960
Constant	**1.096*** **	**1.095*** **	**1.111*** **	**1.100*** **	**1.096*** **
	257.580	267.340	262.690	270.770	244.560
Unique institutional investors	4,078	4,078	4,078	4,078	4,078
Cross-border M&A deals	748	748	748	748	748
Number of observations	75,555	75,555	75,555	75,555	75,555
Wald Chi^2	6887.41	6628.78	6565.32	6507.77	7246.85

Following the methodology of Golubov, Petmezas and Travlos (2012), we identify the “bulge bracket” banks that are generally acknowledged to have superior deal expertise. Specifically, we include a new dummy variable ‘*Top_Advis*’ which accounts for whether the investment bank is bulge bracket or not. The inclusion of this variable in Table 2.4.2.1-A, model 2 does not affect the sign or significance of β_{H2}. In fact '*Top_Advis*' loads with a significant negative coefficient. This result is slightly surprising as large investment banks are expected to supply clients with regional expertise due to their large scale and global reach. However, our sample differs significantly from the reference paper in that we focus only on cross-border transactions and often on public-to-private transactions. Our result seems to suggest that although top tier

advisors can add significant deal-specific expertise, they are less likely to add value in terms of regional specific expertise.

We identify those deals for which internal expertise on the target region's M&A environment may already exist, by accounting for the cases in which the acquirer already has a foreign subsidiary in the target region at the time of the deal announcement. This new variable, '*Prior_Sub*', loads with a significant positive coefficient (Table 2.4.2.1-A, model 3); however, its inclusion does not affect the sign or significance of β_{H2}, suggesting that any internal expertise gained from having a foreign subsidiary does not negate the role of institutional investors. In addition, we use a dummy variable '*Domic_Tar_Reg*' to control for the possibility that the regional expertise of the institutional investor does not solely stem from it being domiciled in the target region – as opposed to being an investor in the target region which is our main proxy for expertise. The results show that this additional control variable loads with a significant positive coefficient but, as in all the cases described above, it does not affect the sign or significance of β_{H2}. We also report the results of adding all of the above variables that account for alternative sources of foreign market expertise jointly in Table 2.4.2.1-A, model 5. The inclusion of these new control variables does not negate the positive effect of the institutional investor knowledge of the target region.

Finally, we consider whether the number of joint ventures or strategic alliances that the acquirer company has already completed in the region of the target, which we label '*Prior_JV_or_Alliance'*, can have an effect on post-M&A performance. We also interact this additional control variable with our variable for divergence between the acquirer and target country, *'Rel_Maturity*'. The new variable, '*Prior_JV_or_Alliance*', loads with a small significant positive coefficient (Table 2.4.2.1-B, model 1) while the interaction variable, *'Prior_JV_or_Alliance x Rel_Maturity'*, does not load with a significant coefficient (Table 2.4.2.1-B, model 2). The sign and significance of β_{H2} remain unaffected (Table 2.4.2.1-B, models 1 and 2).

Table 2.4.2.1-B: Analysis of t-1m to t+12m post-M&A performance (Alternative sources of regional expertise continued)

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Prior_JV_or_Alliance x Rel_Maturity is the natural logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealing Acq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Rel_Maturity' is the difference between acquirer and target M&A maturity, and 'Prior_JV_or_Alliance' the natural

	(1)	(2)
Institutional investor expertise		
Knl_II	**0.010****	**0.010****
	2.360	2.380
KnI_II x Rel_Maturity	**0.678*****	**0.696*****
	7.040	7.200
Prior_JV_or_Alliance x Rel_Maturity		-0.007
		-1.120
Control variables		
Cult_Dist	**-0.008*****	**-0.008*****
	-8.810	-8.530
Prct_Held_B	**-0.236*****	**-0.236*****
	-2.610	-2.610
Deal_Val	**-0.024*****	**-0.024*****
	-24.660	-24.000
Hostile	**-0.028*****	**-0.029*****
	-3.410	-3.470
Ind_Relat.	**0.041*****	**0.041*****
	19.310	19.320
All_Cash	**0.059*****	**0.059*****
	32.860	32.860
$MV\_BV_{Acq\ Y-1}$	**-0.001*****	**-0.001*****
	-69.170	-69.270
$TD\_TA_{Acq\ Y-1}$	**-0.014****	**-0.012***
	-2.070	-1.650
$Liquid_{Acq\ Y-1}$	**-0.296*****	**-0.294*****
	-29.300	-27.630
$Turnov_{Acq}$	**-0.088*****	**-0.089*****
	-9.200	-9.140
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**0.079*****	**0.078*****
	21.060	21.060
Rel_Maturity	**0.079*****	**0.083*****
	4.830	4.790
Prior_JV_or_Alliance	**0.001*****	**0.001*****
	91.180	90.360
Constant	**1.442*****	**1.440*****
	126.860	123.260
Unique institutional investors	4,078	4,078
Cross-border M&A deals	748	748
Number of observations	75,555	75,555
Wald Chi^2	30581.50	32166.97

logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectivel

2.4.2.2. Alternative measures of the discrepancy in M&A environments

It is possible that there are other, more adequate measures of the discrepancy between the target and acquirer's M&A environments. We use the geographic distance between the target and acquirer countries as an alternative measure of market discrepancy. We test to see if this new variable *'Geog_Dist'* can replace *'Rel_Maturity*' as the explanatory variable for coefficient β_{H2} (Table 2.4.2.2-A, model 1). While the new variable loaded by itself with significant negative coefficient, the interaction coefficient β_{H2} , *'Knl_II x Geog_Dist'*, was not significant. In Table 2.4.2.2-A, model 2, we allowed both *'Rel_Maturity*' and *'Geog_Dist*' to interact with *'Knl_II'* and found, as hypothesized, that only *'Rel_Maturity*' interacted with *'Knl_II'* is significant. In an untabulated analysis, we also tested market discrepancy using a different proxy, a dummy variable which is equal to one when the target and acquirer are domiciled in different geographical regions, with the sign and significance of our main variable of interest, β_{H2} , remaining unaffected. These results present additional evidence in favour of our original premise that the role of institutional investors as information providers is not simply explained by geographic distance but instead by differences in the maturity of markets. We expected this result as while, for example, Singapore is a long geographic distance from the US, the relative maturity of their M&A markets are quite similar and we would not expect the potential information provision of institutional investors to be of as much value as when the difference between the relative maturities of the countries is greater. That is, it is not geographic distance that matters but ‘distance’ in relative maturities.

Table 2.4.2.2-A: Analysis of t-1m to t+12m post-M&A performance (Alternative measures of the discrepancy in M&A environments)

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'KnI_II x Geog_Dist' is knowledge-intensive institutional investors *multiplied by* the natural logarithm of the geographic distance between the acquirer and target regions, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealingAcq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Rel_Maturity' is the difference between acquirer and target M&A maturity, and 'Geog_Dist' is the natural logarithm of the geographic distance between the acquirer and target regions. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is

	(1)	(2)
Institutional investor expertise		
KnI_II	0.018	0.004
	0.730	0.180
KnI_II x Rel_Maturity		**0.356*****
		3.730
KnI_II x Geog_Dist	-0.003	-0.001
	-0.850	-0.420
Control variables		
Cult_Dist	0.000	-0.001
	0.330	-1.200
Prct_Held_B	-0.078	-0.073
	-0.950	-0.890
Deal_Val	**-0.029*****	**-0.027*****
	-31.090	-30.010
Hostile	**-0.023*****	**-0.028*****
	-2.570	-3.100
Ind_Relat.	**0.040*****	**0.036*****
	18.870	17.160
All_Cash	**0.065*****	**0.064*****
	36.210	34.710
$MV\_BV_{Acq\ Y\text{-}1}$	**-0.001*****	**-0.001*****
	-72.670	-72.710
$TD\_TA_{Acq\ Y\text{-}1}$	0.008	0.007
	1.150	1.040
$Liquid_{Acq\ Y\text{-}1}$	**-0.267*****	**-0.269*****
	-26.460	-26.390
$Turnov_{Acq}$	**-0.110*****	**-0.154*****
	-11.880	-16.080
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**0.081*****	**0.076*****
	22.670	20.480
Rel_Maturity		0.025
		1.490
Geog_Dist	**-0.027*****	**-0.028*****
	-18.140	-18.030
Constant	**1.486*****	**1.491*****
	96.930	96.980
Unique institutional investors	4,078	4,078
Cross-border M&A deals	748	748
Number of observations	75,555	75,555
Wald Chi^2	10757.89	11330.51

748 deals. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

2.4.2.3. Alternative measures of M&A success

We use a range of different performance measures, including regional and size BHAR benchmarks run over medium-term ($_{t\text{-}1m\ to\ t+12m}$) and long-term ($_{t\text{-}1m\ to\ t+36m}$) event windows. The sign and significance of $\square_{H2}$ remain unchanged (Table 2.4.2.3-A, models 1 through 4). In addition, as an alternative measure of success we also collect data on the value of impairments in any of the five years following completion of the deal. With this new dependent variable, Table 2.4.2.3-B, model 1 reports that the significance of $\square_{H2}$ remains unchanged, with a negative sign, since more subsequent impairments are associated with less success. We also measure performance by considering the likelihood of deal completion after controlling for whether the deal is a tender offer '*Tender Offer*', whether there is a competing bid, '*Competing Bid*', and whether there is a target firm termination fee clause, *'Target Term Fee'*. Again, the sign and significance of $\square_{H2}$ remain unchanged (Table 2.4.2.3-B, model 2). Note that we use a larger deal data sample for this model, which includes the terminated deals in the same time period.

Table 2.4.2.3-A: Analysis of t-1m to t+12m and t-1m to t+36m post-M&A performance (Alternative measures of M&A success)

The dependent variable is the acquirer BHAR returns over the -1 to +12 months and -1 to +36 months period adjusted by the MSCI Regional or Regional & Size indices of the acquirer. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealingAcq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, and 'Rel_Maturity' is the difference between acquirer and target M&A maturity. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively

	(1) MSCI Regional Index, t-1m to t+12m	(2) MSCI Regional & Size Index, t-1m to t+12m	(3) MSCI Regional Index, t-1m to t+36m	(4) MSCI Regional & Size Index, t-1m to t+36m
Institutional investor expertise				
Knl_II	**0.027*** **	**0.032*** **	**0.038*** **	**0.021*** **
	9.040	10.450	7.620	4.370
Knl_II x Rel_Maturity	**1.068*** **	**1.052*** **	**1.086*** **	**0.671*** **
	14.050	13.720	9.300	5.950
Control variables				
Cult_Dist	0.001	**0.002*** **	**-0.027*** **	**-0.025*** **
	1.130	2.780	-19.480	-20.800
Prct_Held_B	0.017	-0.053	0.023	-0.162
	0.330	-0.980	0.210	-1.490
Deal_Val	**-0.014*** **	**-0.015*** **	**-0.035*** **	**-0.027*** **
	-26.450	-27.060	-35.530	-24.420
Hostile	**-0.085*** **	**-0.066*** **	**-0.095*** **	-0.007
	-16.590	-15.750	-9.680	-0.780
Ind_Relat.	**0.009*** **	**0.003***	**0.113*** **	**0.092*** **
	6.030	1.700	38.890	31.660
All_Cash	**0.069*** **	**0.059*** **	**0.086*** **	**0.070*** **
	46.930	42.920	37.870	32.040
$MV\_BV_{Acq\ Y-1}$	**0.000*** **	**0.000*** **	**-0.003*** **	**-0.002*** **
	-19.460	-23.540	-25.030	-14.170
$TD\_TA_{Acq\ Y-1}$	**0.017*** **	**-0.027*** **	**0.059*** **	**-0.018***
	3.810	-6.150	5.550	-1.790
$Liquid_{Acq\ Y-1}$	**-0.224*** **	**-0.252*** **	**-0.313*** **	**-0.333*** **
	-30.560	-32.660	-24.960	-25.130
$Turnov_{Acq}$	**-0.081*** **	**-0.069*** **	**-0.240*** **	**-0.250*** **
	-12.470	-10.790	-23.880	-24.080
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**0.022*** **	**0.036*** **	**0.035*** **	**0.081*** **
	8.240	13.370	7.350	17.580
Rel_Maturity	**-0.060*** **	**-0.056*** **	**0.206*** **	**0.093*** **
	-4.680	-4.520	9.630	4.640
Constant	**1.103*** **	**1.109*** **	**1.310*** **	**1.263*** **
	273.880	264.010	162.160	138.130
Unique institutional investors	4,078	4,038	3,758	3,579
Cross-border M&A deals	748	706	697	596
Number of observations	75,555	72,152	64,945	57,404
Wald Chi^2	6460.80	6244.76	9317.86	6225.86

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Table 2.4.2.3-B: Analysis of t-1m to t+12m post-M&A performance (Alternative measures of M&A success continued)

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealingAcq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Rel_Maturity' is the difference between acquirer and

	(1) Dependent variable: impairment of goodwill	(2) Dependent variable: likelihood of deal completion
Institutional investor expertise		
KnI_II	**-75.545***** -12.090	**0.352***** 10.680
KnI_II x Rel_Maturity	**-871.225***** -5.880	**3.427***** 4.280
Control variables		
Cult_Dist	**34.201***** 26.230	**0.025***** 4.060
Prct_Held_B	-41.567 -0.760	**1.686**** 2.210
Deal_Val	**-28.679***** -38.310	**-0.130***** -25.870
Hostile	**98.691***** 39.050	Omitted
Ind_Relat.	**-5.487**** -2.200	**0.471***** 25.090
All_Cash	**60.640***** 29.460	**-0.088***** -5.630
$MV\_BV_{Acq\ Y\text{-}1}$	**-0.263***** -26.130	**0.020***** 16.890
$TD\_TA_{Acq\ Y\text{-}1}$	**83.798***** 12.070	**-1.345***** -33.520
$Liquid_{Acq\ Y\text{-}1}$	**232.189***** 31.470	**-1.385***** -22.570
$Turnov_{Acq}$	**-22.800***** -4.400	**0.181***** 3.670
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**77.533***** 42.830	**-0.936***** -37.300
Rel_Maturity	**-759.877***** -18.750	**-0.268**** -2.000
Tender_Offer		**-0.068***** -4.290
Competing_Bidder		**-0.265***** -11.480
Target_Term_Fee		-0.008 -0.410
Constant	**94.262***** 27.170	**2.769***** 68.460
Unique institutional investors	3,154	4,832
Cross-border M&A deals	174	797
Number of observations	43,256	81,315
Wald Chi^2	4952.87	4867.45

target M&A maturity, 'Tender_Offer' equals 1 if the deal is classified as a 'tender offer' by the SDC Platinum Database and 0 otherwise, 'Competing_Bidder' equals 1 if there are any competing bidders and 0 otherwise, and 'Target_Term_Fee' equals 1 if there is a target company termination fee clause in the deal agreement document and 0 otherwise. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. For Table 2.4.3-B, the underlying deal data sample for Model 1 is 177 and for Model 2 it is 797. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

2.4.2.4. Deal level, serial acquirers and primary index-listing sensitivity analysis

In order to see whether the positive effect of institutional investor expertise applies to companies listed on non-primary exchange indices, we re-estimate our original regressions with a larger sample of all public acquirers. The results reported in Table 2.4.2.4-A, model 1 demonstrate that the sign and significance of β_{H2} remain unchanged.[19] It should be noted that in Table 2.4.2.4-A, we re-estimate the original regressions with the larger sample by including all the additional controls simultaneously in the regression (Table 2.4.2.4-A, model 2). The sign and significance of β_{H2} remain unchanged. To control for the possibility that some acquirers may complete more than one M&A deal within the same BHAR event window, we re-estimate model 2 in Table 2.4.2.4-A by using a sample of non-serial acquirers only. Adding this restriction considerably reduces the sample size however the sign and significance of β_{H2} remain unchanged.

As our primary concern is the knowledge of specific institutional investors (who may be present on multiple deals), our main unit of analysis is each institutional investor's portfolio holding in the target region. As already stated, we control for clusters of investor name as each investor could be on several acquirer's share registers. However, there is a second potential cluster effect, namely that of each deal. As we cannot test for the deal-level cluster effect in the current model we replicate the analysis on a deal level, with the results reported in Table 2.4.2.4-B. Our original results on the sign and significance of β_{H2} remain unchanged. We perform this analysis using the original controls (Table 2.4.2.4-B, model 1) and also including the additional controls (Table 2.4.2.4-B, model 2). We control for the potential noise in the data caused by follow-on acquisition effect our BHAR event window by performing the regressions excluding any deal which is performed by a 'serial acquirer' – here defined as one which completes multiple deals within a time window of three years in model 3.[20]

[19] We note that there are two additional control variables included in Tables Table 2.4.2.4-A and Table 2.4.2.4-B, namely, 'Any_II_Leave' (which measures the number of institutional investors that sell their holdings in the acquirer company within six months of a deal announcement) and 'Acquisitive_CrossBorder_Mean' (which accounts for the acquirers that perform a number of international deals which is greater than the average number of international deals completed by all firms within the last year and zero otherwise). These additional controls were inspired by comments received at conference presentations.

[20] We note that the sign and significance of the coefficient β_{H2} remains but the magnitude of the coefficient increases dramatically. While this agrees with our hypothesis, we suggest the exercise of caution here as removing serial acquirers has taken our sample size down to just 91 deals.

Table 2.4.2.4-A: Analysis of t-1m to t+12m post-M&A performance (Deal level, serial acquirers and primary index-listing sensitivity analysis)

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is knowledge-intensive institutional investors, 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealing Acq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Rel_Maturity' is the difference between acquirer and target M&A maturity, 'Domic_Tar_Reg' equals 1 when the institutional investor on the acquirer's share register is domiciled in the target region, 'Prior_Exp' equals 1 when the acquirer completed an earlier deal in the target region, 'Top_Advis' equals 1 when the acquirer is advised by a global investment bank, 'Prior_Sub' equals 1 when the acquirer has a subsidiary in the target region, 'Any_II_Leave' is the number of institutional investors that dispose of their holdings in the acquirer company within six months of the M&A deal announcement, 'Geog_Dist' is the natural logarithm of the geographic distance between the acquirer and target regions, 'KnI_II x Geog_Dist' is knowledge-intensive institutional investors *multiplied by* the natural logarithm of the geographic distance between the acquirer and target regions, 'Prior_JV_or_Alliance' is the natural logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal, 'KnI_II x Prior_JV_or_Alliance' is knowledge-intensive institutional investors *multiplied by* the natural logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal, 'Acquisitive_CrossBorder_Mean' equals 1 when the acquirer has completed a number of international deals which is greater than the average number of international deals completed by all firms within the last year and 0 otherwise. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. For Table 2.4.2.4-B, the underlying deal data sample for Model 1 and 2 is 2,065 and for Model 3 it is 531. Note that the number of additional new unique institutional investors for the large sample is small in relation to how many new deals are added to the sample. All added deals refer to deals completed by acquirers which are not part of the constitute of the primary index. When one looks at all the extra deals completed by smaller acquirers or acquirers listed on the secondary exchanges, the number of new unique institutional investors that are now present, but were not present on deals only on the primary index-listed acquirers' share register is small. This is not surprising as few institutional investors specialize only in smaller companies or companies listed on the secondary exchanges. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively

	(1) Large sample, original model, *Institutional Investor level*	(2) Large sample all controls, *Institutional Investor level*	(3) Large sample all controls excl. serial acquirers, *Institutional Investor level*
Institutional investor expertise			
Knl_II	**0.006***	-0.001	0.001
	1.650	-0.250	0.140
KnI_II x Rel_Maturity	**0.434*****	**0.529*****	**2.042*****
	8.260	4.520	9.320
Control variables			
Cult_Dist	0.000	**-0.016*****	**0.025*****
	0.160	-15.430	11.930
Prct_Held_B	-0.088	**-0.208*****	**-0.255*****
	-1.510	-3.530	-3.120
Deal_Val	**-0.010*****	**-0.004*****	**-0.010*****
	-16.870	-4.010	-6.070
Hostile	**-0.072*****	-0.005	**0.044*****
	-14.260	-1.350	4.020
Ind_Relat.	**0.030*****	**0.034*****	**0.053*****
	14.730	12.870	9.770
All_Cash	**0.031*****	**0.014*****	**0.032*****
	17.360	6.260	6.230
$MV\_BV_{Acq\ Y-1}$	**0.000*****	**0.000*****	**0.000*****
	10.000	-3.180	-1.020
$TD\_TA_{Acq\ Y-1}$	**-0.122*****	**-0.042*****	**-0.215*****
	-16.510	-3.490	-10.710
$Liquid_{Acq\ Y-1}$	**-0.204*****	**-0.214*****	-0.029
	-25.800	-17.650	-1.240
$Turnov_{Acq}$	**-0.139*****	-0.016	**-0.056*****
	-18.260	-1.480	-2.980
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	**0.053*****	**-0.020*****	**0.039*****
	16.190	-4.560	4.980
Rel_Maturity	**-0.230*****	**0.889*****	**-0.315*****
	-14.680	11.620	-3.090
Domic_Tar_Reg		**0.006****	**0.029*****
		2.020	4.740
Top_Advis		**-0.026*****	**0.028*****
		-8.880	5.160
Prior_Sub		**-0.045*****	**0.049*****
		-11.590	7.170
Prior_Exp		**0.000*****	**0.003*****
		-3.040	20.010
Prior_JV_or_Alliance		**0.016*****	**-0.022*****
		9.980	-5.050
Prior_JV_or_Alliance x Rel_Maturity		**-0.046*****	**0.118*****
		-3.030	3.220
Any_II_Leave		**-0.026*****	**-0.032*****
		-5.890	-4.700
Geog_Dist		**0.004****	**0.019*****
		2.540	6.380
KnI_II x Geog_Dist		**-0.070*****	**0.081*****
		-6.610	4.860
Acquisitive_CrossBorder_Mean		**-0.016*****	Omitted
		-4.680	
Constant	1.134***	**1.125*****	**0.824*****
	226.840	83.010	28.070
Unique institutional investors	4,085	4,085	2,541
Cross-border M&A deals	2,065	2,065	531
Number of observations	123,585	123,585	24,693
Wald Chi^2	1690	2702	2401.21

Table 2.4.2.4-B: Analysis of t-1m to t+12m post-M&A performance (Deal level, serial acquirers and primary index-listing sensitivity analysis continued

The dependent variable is the acquirer BHAR returns over the -1 to +12 months period adjusted by the MSCI World Size Index corresponding to each acquirer company. 'KnI_II' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register, 'KnI_II x Rel_Maturity' is the portfolio allocation in the target region of the knowledge-intensive institutional investors on the acquirer share register *multiplied by* the difference in M&A maturity between the target and acquirer countries, 'Cult_Dist' is the cultural distance between the acquirer and target countries, 'Prct_Held_B' is the percentage of outstanding shares which each institutional investor has in the acquirer, 'Deal_Val' is the M&A deal value measured in millions of US $, 'Hostile' equals 1 when the deal is hostile and 0 otherwise, 'Ind_Relat.' equals 1 when the target and acquirer operate in the same industry and 0 otherwise, 'All_Cash' equals 1 when the method of payment is all cash and 0 otherwise, 'MV_BV_{Acq}' is the market-to-book ratio of the acquirer, 'TD_TA_{Acq}' is the ratio of total debt to total assets, '$Liquid_{Acq}$' is the ratio of cash and cash equivalents to total assets, '$Turnov_{Acq}$' is the trading volume divided by total outstanding shares three months before the announcement of the deal, '$Anti\text{-}self\text{-}dealingAcq\text{-}_{Tar}$' is the difference between the acquirer and target countries' anti-self-dealing index values, 'Rel_Maturity' is the difference between acquirer and target M&A maturity, 'Domic_Tar_Reg' equals 1 when the institutional investor on the acquirer's share register is domiciled in the target region, 'Prior_Exp' equals 1 when the acquirer completed an earlier deal in the target region, 'Top_Advis' equals 1 when the acquirer is advised by a global Investment Bank, 'Prior_Sub' equals 1 when the acquirer has a subsidiary in the target region, 'Any_II_Leave' is the number of institutional investors that dispose of their holdings in the acquirer company within six months of the M&A deal announcement, 'Geog_Dist' is the natural logarithm of the geographic distance between the acquirer and target regions, 'KnI_II x Geog_Dist' is knowledge-intensive institutional investors *multiplied by* the natural logarithm of the geographic distance between the acquirer and target regions, 'Prior_JV_or_Alliance' is the natural logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal, 'KnI_II x Prior_JV_or_Alliance' is knowledge-intensive institutional investors *multiplied by* the natural logarithm of the number of joint ventures or strategic alliances that the acquirer completed in the target region before the current deal, 'Acquisitive_CrossBorder_Mean' equals 1 when the acquirer has completed a number of international deals which is greater than the average number of international deals completed by all firms within the last year and 0 otherwise. We estimate our regressions with fixed effect panel specification, where the unique investor name represents the cluster variable in the panel. For our main regression specification, where we use the acquirer BHAR returns over the 12-month period post-M&A performance adjusted by the MSCI World Size Index, the underlying deal data sample is 748 deals. To correct for the possibility that our coefficients are not estimated on the basis of a random sample or that the distributions of our independent variables and regression residual are not independent or identically distributed (i.i.d.), all models have a robust estimate of variance following Huber (1967) and White (1980, 1982). T-stats are reported below each independent variable. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively

	(1) Original sample, original model, *deal level*	(2) Original sample, all controls, *deal level*	(3) Original sample, all controls, excl. serial acquirers, *deal level*
Institutional investor expertise			
Knl_II	**0.046****	**0.116****	0.083
	2.140	2.250	0.810
KnI_II x Rel_Maturity	**0.289****	**1.983*****	**4.519*****
	2.390	3.680	3.980
Control variables			
Cult_Dist	-0.009	**-0.030***	0.016
	-0.780	-1.950	0.550
Deal_Val	-0.007	0.009	0.004
	-0.760	0.660	0.120
Hostile	0.136	-0.010	-0.001
	0.820	-0.130	-0.010
Ind_Relat.	**0.061****	0.015	-0.024
	2.270	0.390	-0.280
All_Cash	0.038	0.011	-0.036
	1.450	0.300	-0.420
$MV\_BV_{Acq\ Y-1}$	**-0.001*****	**-0.001*****	**-0.001****
	-3.070	-3.880	-2.250
$TD\_TA_{Acq\ Y-1}$	0.060	0.169	0.110
	0.740	1.240	0.360
$Liquid_{Acq\ Y-1}$	**-0.236***	-0.036	0.309
	-1.830	-0.210	0.950
$Turnov_{Acq}$	-0.030	0.080	0.087
	-0.190	0.320	0.180
$Anti\text{-}self\text{-}dealing_{Acq\text{-}Tar}$	0.057	0.011	0.027
	1.220	0.200	0.230
Rel_Maturity	**-0.583***	-0.342	-0.402
	-1.850	-0.910	-0.520
Any_II_Leave	**-0.055***	**-0.120*****	-0.096
	-1.930	-2.930	-1.150
Top_Advis		-0.022	-0.004
		-0.550	-0.050
Prior_Sub		0.005	0.072
		0.110	0.640
Prior_Exp		0.000	0.004
		-0.440	1.640
Prior_JV_or_Alliance		-0.013	**-0.088***
		-0.640	-1.860
Prior_JV_or_Alliance x Rel_Maturity		0.048	**-1.041***
		0.300	-1.870
Geog_Dist		**0.030***	**0.063***
		1.770	1.840
Knl_II x Geog_Dist		**0.000*****	**0.000*****
		-3.170	-2.760
Acquisitive_CrossBorder_Mean		-0.027	Omitted
		-0.720	
Constant	**1.124*****	**0.789*****	0.437
	14.880	4.510	1.180
Number of observations / Cross-border M&A deals	748	748	91
R^2	0.0465	0.1425	0.3068

2.5. Conclusion

Traditional research on information flows in financial markets concentrates on flows from firms to investors. However, motivated by the earlier theoretical work of Dye and Sridhar (2002), we investigate whether there may be value in information which flows in the opposite direction, i.e. from investors to firms. Keeping within the spirit of the Dye and Sridhar model, we look at cross-border M&A deals with potentially widely distributed information and attempt to identify settings in which the management of firms could learn from investors which have experience and expertise in the target region. We propose here that such expertise held by investors is likely to benefit the management of a potential acquirer most when the target country is significantly less developed in terms of M&A maturity compared to the acquirer country, i.e. when the divergence of the two markets is large and hence the extent of information asymmetry is greater. Thus, we conclude that going naked (without informed investor support) into foreign deals in complex (diverse maturity), cross-regional settings may be dangerous for the bottom line.

3. Acquisitions, SEOs, Divestitures and IPO Performance

Naaguesh Appadu, Anna Faelten, Mario Levis

3.1. Introduction

Since the early 1990s, when Ritter (1991) first documented the aftermarket underperformance of IPOs, a considerable amount of empirical research across many countries[21] has corroborated his findings and highlighted some significant differences in performance across different types of IPOs.[22] Post-event market underperformance, however, is not a unique feature of IPOs. A number of studies, for example, report that firms with seasoned equity offerings (SEOs) underperform in comparison to similar non-issuing firms in the three-year period following the issue (Loughran and Ritter (1995), Spiess and Affleck-Graves (1995) and Iqbal, Espenlaub and Strong (2006)). Furthermore, despite the positive initial returns for firms announcing acquisitions, there is considerable evidence suggesting negative post-event performance at least for stock-financed acquisitions (Loughran and Vijh (1997), Rau and Vermaelen (1998) and Wiggenhorn, Gleason and Madura (2007)).

Raising additional equity capital and acquisitions are quite common among recently listed firms. Survey evidence of US and European CFOs, on the motivation of IPOs, (Brau and Fawcett (2006) and Bancel and Mittoo (2009)) and the actual record of corporate activity of recent IPOs (Hovakimian and Hutton 2010b) suggest that such activities are an integral part of future strategy for growth. Divestitures are also widely used by firms in general as part of an overall strategic plan and are often related to recent acquisitions. In contrast to SEOs and acquisitions, however, they tend to be value enhancing (Dranikoff, Koller and Schneider (2002), Hollowell (2009) and Lee and Madhavan (2010)). Given the similarities in the post-event performance patterns of IPOs and acquisitions, Brau, Couch and Sutton (2012) argue that acquisitions by recently listed firms may be account for the aftermarket underperformance of IPOs. A similar type of argument could apply for SEOs as well.

In spite of the considerable evidence on the extent of individual corporate activity, in terms of acquisitions, seasoned equity offering and divestitures, by recently listed firms, there is still relatively limited empirical evidence on the implications of the range of such activities subsequent performance.[23] The purpose of this paper is to investigate the pattern of these three types of follow-on corporate activities during the 3-year period since flotation and their implications on the long-run aftermarket performance of recent IPOs.

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[21] See, for example, Levis (1993) for the UK and Chan, Wang and Wei (2004) for China.

[22] Newly listed firms, for example, with certain characteristics in terms of size (Ritter (2011)), underwriters' or venture capital sponsors' reputation (Chan, Cooney, Kim and Singh (2008) and Krishnan, Ivanov, Masulis and Sigh (2011)), privatizations (Choi, Lee and Megginson (2010), and PE backing (Brav and Gompers (1997), Cao and Lerner (2009), and Levis (2011)) show positive aftermarket performance.

[23] In a recent paper, Brau Couch and Sutton (2012) examine the long term performance of IPO companies involved in subsequent acquisitions, while Billett, Flannery and Garfinkel (2011) investigate the implications of different issuing activities on long term performance.

In this chapter, we test and find support for strong linkages in the type, timing and pattern underpinning the different kinds of post-IPO corporate event; furthermore, we also show that such characteristics of corporate events have a defining effect on the aftermarket performance of IPO companies. Recent IPO firms involved in a series of acquisitions and/or seasoned equity offerings perform relatively better in comparison to others who remain either totally inactive or just have a single, probably opportunistic, event without a coherent plan for future growth. This could also be the result of an inherent sample bias as firms that realize their set objectives of a recent completed corporate transaction are unlikely to return for more at least in the immediate future. In this sense, the superior performance of the firms displaying a pattern of continued corporate activity is to be expected. By showing that the aftermarket performance of IPO companies relates both to the pattern and underlying motivation of their follow-on transactions, we highlight an additional important dimension of the long-standing debate of IPO firms' aftermarket performance. More specifically, we argue that a public listing on its own is not necessarily the determining factor of aftermarket performance; instead, the newly listed firms' competitive position and management's ability to utilize their public status to pursue growth opportunities have a defining impact on future performance.

We start our analysis by providing a detailed account of the types of corporate event undertaken by IPO firms within the first three years of their listing. We find that a total of 82% of the IPO companies in our sample were involved in at least one of the three types of corporate event, while half of them had at least one acquisition or SEO. Overall, acquisitions, either in cash, stock or both, were by far the most popular type of corporate event, accounting for 54% of all of the events in the sample.

In the second part of the paper, we examine the underlying characteristics of each of the three types of corporate event. We find that the IPO firms mostly involved in acquisitions are larger and more profitable, with a strong market debut and good recent stock performance at least for stock financed transactions. SEOs also come early after the IPO at times of positive market sentiment following a recent run of good stock performance, but on average are the less profitable IPO firms that raise additional equity capital. Divestitures, on the other hand, come later and involve considerably larger firms in the Main market and low cash balances. We also find that the underlying motivation for the same type of transaction may change over time. An acquisition, SEO, or a divestiture, for example, is sometimes driven by pure demand for capital while at other times occur predominantly due to market timing considerations.

Second, we investigate the aftermarket performance of IPO companies on the basis of the type and pattern of their follow-on corporate activities, in terms of acquisitions, SEOs, and divestitures. We find strong evidence that IPO firms that engage in a number of SEOs and acquisitions during the three-year post-IPO period perform significantly better than, their inactive counterparts. Although a casual comparison of our results with the evidence of previous studies may indicate noticeable inconsistencies, these are due to differences in the sample characteristics and the methodological approach between this and other studies. More specifically, instead of examining a specific type of corporate event in isolation, we take a rounded view of a firm's follow-on corporate event activities and their implications to performance. Our rationale for this integrated approach reflects our underlying view that a series of follow-on corporate activities is a better indicator of a firm's planned strategy for growth.

To the best of our knowledge, this is the first study that explicitly recognizes and traces the activity and patterns of three of the most common types of event during a three-year period in the aftermarket. By examining the underlying company characteristics, patterns and motivation behind each of the three types of event over different time periods after the IPO, we show that the drivers behind them differ not only across the three events but for each specific event over different time periods.

More generally, we also contribute to the literature by showing that the average aftermarket underperformance of IPO companies conceals a wide range of diverse performances that relate to the timing and type of their follow-on decisions during the first 3 years after flotation.

The rest of the paper is organized as follows: Section 3.2 provides a review of the related literature. Section 3.3 describes the data and methodology and section 3.4 (parts A, B and C), provides a detailed mapping of the type and sequence of the three corporate events during the three-year period following the IPO. Section 3.5 examines the underlying characteristics of acquisitions, SEOs and divestitures and Section 3.6 reports on IPO companies' aftermarket performance according to different types of corporate activity. Finally, section 3.7 we summarize the results and highlight the key conclusions and potential implications of our study.

3.2. Related Literature

The popularity of follow-on corporate by newly listed firms is consistent with the view that an IPO is the first step towards a long-term plan for growth. An IPO, for example, offers the opportunity to raise the cash or use the publicly traded stock for future acquisitions (Mikkelson, Partch and Shah, (1997) and Brau, Francis, and Kohers, (2003)) and reduce information asymmetry (Eckbo, Gianmarino and Heinkel, (2011)). The survey of chief financial officers by Brau and Fawcett (2006) provides considerable support for the latter position. Capital infusion and alleviation of information uncertainty, however, are not the only links between an IPO and a merger. A public listing may also facilitate a subsequent stock merger by reducing valuation uncertainty and leading to more efficient, acquisition strategies (Hsieh, Lyandres and Zhdanov, (2011)).

Recent empirical evidence by Hovakimian and Hutton (2010a) and Celikyurt, Sevilir and Shivdasani (2010), provides even further support for the importance of acquisitions for newly listed firms. They show that the future growth of IPO firms is mainly through acquisitions rather than capital expenditure or R&D; IPO firms are also more prolific acquirers in comparison to their more mature counterparts within their industry (Maksimovic, Phillips and Yang, (2010)).

Acquisitions may also stimulate demand for additional capital leading to further capital raising rounds. Welch (1989), for example, finds significantly higher levels of secondary issue offerings among recently floated firms than one would expect among a random sample of firms. The surge in post-IPO acquisitions, however, may also lead to divestitures as certain parts of the acquired assets, which do not fit into the newly developed entity, may be disposed of to improve profitability. Divestitures, of course, could also be related to market feedback and the enhanced liquidity enjoyed by the public listing.

The poor aftermarket performance of acquisitions and seasoned equity offerings is often attributed to the market misevaluation hypothesis (Shleifer and Vishny (2003), Baker, Stein, and Wurgler (2003)), which leads to opportunistic behavior and the tendency of managers to exploit their informational advantage by timing their financing and investment decisions to take advantage of overvalued stock prices.[24] A number of studies provide evidence that is broadly consistent with the market timing of IPOs and SEOs (Loughran and Ritter (1995), Levis (1995), Jiang (2008) and Kim and

[24].Schultz (2003) shows that underperformance by firms following equity offerings is very likely to be observed ex-post in an efficient market and can be explained by a 'pseudo' market timing hypothesis. Thus, more firms may issue equity at higher stock prices even when the market is efficient and there is no timing ability.

Weisbach (2008)), acquisitions (Loughran and Vijh (1997), Rhodes-Kropf, Robinson and Viswanathan (2005) and even divestitures (Brauer and Stussi (2010)).

Financing and investment decisions may also be motivated by feedback received from the market that helps to pursue expected growth opportunities. Jegadeesh, Weinsten, and Welch (1993), for example, show that IPOs followed by high returns are associated with a higher probability of follow-on SEOs within three years of the IPO. More recently, Hovakimian and Hutton (2010b) also report that firms with high post-equity-issue returns are more likely to return to the market for additional rounds of equity financing. They argue that these results are consistent with the market feedback hypothesis in that high post-issue returns encourage managers to return to the market for additional funding. It is important to note, however, that such a pattern of follow-on equity issues may also be the direct outcome of strategic (demand for capital) rather than opportunistic (overvaluation) transactions.

Lowry and Schwert (2002) highlight an additional dimension of the market feedback hypothesis by reporting that IPO volume and average initial returns are highly autocorrelated, i.e. companies tend to go public following periods of high initial returns. Both the cycles of initial returns and the lead-lag relationship between initial returns and IPO volume are predominantly driven by information learned during the registration period. More positive information results in higher initial returns and more companies filing IPOs soon thereafter. Recent increases in the price of acquiring firms as a result of either positive market feedback or overvaluation is likely to affect stock but not cash-based acquisitions (King, Slotegraaf and Kesner (2008).

Finally, it is also interesting to note that all three types of corporate event (IPOs, acquisitions and SEOs) are not only moving in cycles of their own but, given that the underlying drivers of individual corporate events are broadly similar, there is a significant overlap among them. Lowry (2003), for example, finds that IPO volume fluctuates substantially over time and relates to firms' demands for capital and investor sentiment; Howe and Zhang (2010) show a similar pattern for SEOs. Furthermore, Colak and Tekatli (2010) find that a common factor related to the business cycle can explain a significant proportion of individual corporate events. Moreover, Rau and Stouraitis (2011) find that such corporate event waves are closely linked and even follow certain patterns. For example, SEOs precede IPOs, which are followed by stock-financed merger waves followed in turn by stock repurchase activity. The speed and sequence of corporate event waves may have important implications for the timing of financing and investment decisions. More specifically, a recently floated firm that timed its listing at a 'window of opportunity' for IPOs is likely to be involved soon afterwards in some type of acquisition if the IPO and M&A waves overlap. In such cases, acquisitions by IPO firms are likely to take place within a short time period after flotation.

It is important to note two recent papers that focus explicitly on the long-run performance for firms with follow-on corporate events. Brau, Couch and Sutton (2012) find that IPO companies that acquire within a year of going public significantly underperform in the three years following flotation; on the other hand, non-acquiring IPO firms or those that wait for more than a year after the IPO to become acquirers do not significantly underperform over the same time period. Their paper, however, differs from ours not only on its focus on acquisitions only, but more importantly on its implicit assumption that acquisitions are the only type of follow-on corporate transactions made by recently listed firms. Furthermore, they do not distinguish between cash and stock acquisitions, a feature that is usually

associated with differences in performance (Loughran and Vijh (1997) and Carrow, Heron and Saxton (2004)). In contrast Bessler and Zimmermann (2011), using a pan-European IPO sample,[25] show positive aftermarket long-run performance for acquiring IPO firms. Their study, however, also ignores any other type of corporate activities that the recent IPOs may have been involved after the listing. Billett, Flannery and Gartfinkel (2011) also provide a wider perspective on subsequent corporate activities by examining the implications of a variety of follow-on security issuances on long-run performance. Their results suggest that negative post-issuance returns are related to the number of the different types of security issued; in the case of IPOs, they find that firms that go through a series of post-IPO financing rounds, in the form of bank loans, follow-on SEOs, public debt issues, or private placements of equity significantly underperform. Their evidence implies that undertaking such activities without a strong strategic objective leads to disappointing performance.

3.3. Data and methodology

This study is based on a sample of 1,504 non-financial IPOs listed on the two London markets, the Official List (often referred to as the Main Market) (276 IPOs) and the Alternative Investment Market (AIM) (1,228 IPOs) during the period from January 1995 to March 2008. The basic sample of IPOs originates from London Stock Exchange statistics and covers industry classification, market capitalization, amount raised, and issue price. The data on the follow-on acquisitions (cash and stock), SEOs, and divestitures within the three years after flotation are from Bloomberg and cover the period January 1995 to December 2010. We analyze the entire universe of all completed acquisition and SEO transactions with a stated deal value amount.[26] The financial accounts, stock price returns and macroeconomic data is from Datastream.

Long-term aftermarket performance estimates are based on buy-and-hold abnormal returns (BHARs) for each IPO.[27] These are computed as:

$$BHAR = \frac{1}{N}\sum_{i=1}^{N}\left[\left(\prod_{t=1}^{T}(1+r_{it})\right)-\left(\prod_{t=1}^{T}(1+r_{bt})\right)\right] \qquad (1)$$

where: r_{it} and r_{bt} are the raw returns on IPO i and the selected benchmark b at event month t.

We estimate BHARs using the FTSE All-Share Index for all IPOs listed on the Main market and the Small Cap index for IPOs listed on AIM. Given the concentration of certain industries in our IPO sample we also estimate industry-adjusted BHARs are based on the ten broad FTSE sector indices. The null hypothesis that the mean BHARs are equal to zero is tested using the skewness-adjusted t-statistic with bootstrapped p-values as suggested by Lyon, Barber and Tsai (1999) and adapted by Jelic, Saadouni and Wright (2005).

[25] Their sample includes IPOs from UK, France, Germany and Italy. The UK component, however, is rather limited as it includes only 644 IPOs involved in 400 acquisitions. Our UK sample in this paper during the shorter period (1996-208) includes 1,493 IPOs and 1, acquisitions.

[26]. The number of divestitures is not included in the restriction due to unavailability.

[27]. When a firm in a portfolio is delisted from the database, the portfolio return for the next month is an equally-weighted average of the remaining firms in the portfolio. Thus, the proceeds of the delisted firm are equally allocated among the surviving members of the portfolio in each subsequent month.

We also assess aftermarket performance using the Fama and French (1993) three-factor model with equal- and value-weighted returns as follows:

$$R_{pt} - R_{ft} = a_i + b_i(R_{mt} - R_{ft}) + s\,SMB_t + h\,HML_t + e_t \qquad (2)$$

The three factors are ($R_{mt} - R_{ft}$), the excess return on the value weighted market portfolio, (SMB) the return on a portfolio formed by subtracting the on a large from the return on a small firm portfolio. High minus low (HML) is the return on UK-listed high book-to-market return minus the return of the low book-to-market portfolio and R_f is the 90-day UK Treasury bill rate. The SMB and HML portfolios were constructed using a two-by-three groupings rebalanced every six months throughout the sample period.

3.4. Descriptive statistics of IPOs and follow-on corporate events

3.4.1. Annual Distribution of IPOs and Corporate Events

Table 3.4.1-A provides details of the annual distribution of the sample of 1,504 IPOs during the period January 1995 to March 2008 and their follow-on corporate activities in terms of acquisitions, SEOs, and divestitures. It shows significant variations in both the volume of IPOs and follow-on events during the sample period. The first wave of IPOs ended in the middle of 2000 with the burst of the technology bubble; the market started growing again in 2004 with 218 issues that year and continued for three years until mid-2007, with the peak year being 2005 with 270 issues.[28] In sharp contrast to the strong and almost immediate involvement of a large number of recently listed IPO firms in a frantic spree of acquisitions during 1999-2001, the 2004-2006 cohort was relatively modest and it took almost two years for follow-on acquisitions to peak again. This new wave of IPOs was also different from 1999-2000 as it was followed by strong SEO activity (333 issues) in the subsequent two years. On the other hand, the volume of divestitures appears relatively stable during the entire sample period.[29] The differences in the patterns of the follow-on events between the two waves reflect, to a certain extent, the type and characteristics of the two IPO groups and the corresponding market sentiment at the time. The 1999-2000 wave of IPOs, for example, was dominated by small technology firms listing on AIM, raising modest amounts of capital at relatively high valuations; in contrast, the 2004-2006 cycle was considerably more diverse in terms of industry distribution and market size. Both cycles of IPO, acquisition and SEO activity coincided, however, with corresponding strong market performances.

The 1,504 IPO firms in our sample were involved in 2,938 corporate events during the three-year period after flotation, resulting in an average of 1.9 events per IPO firm. Consistent with the literature on the importance of acquisitions as one of the key objectives for an IPO, more than 50% of the follow-on corporate events (1,587) were acquisitions. In contrast, however, with the CFOs' view that IPOs provide 'currency' for acquisitions, unreported results show that pure cash transactions ac-

[28]. Although the overwhelming majority of the IPO firms during this period (79.7%) were listed on the Alternative Investment Market (AIM), they accounted for only 15.2% of the total amount raised. In other words, the average (median) amount raised by an IPO on the MAIN market is £233m (£81m) in comparison to an equivalent £11m (£5m) on AIM.

[29].As the data on divestiture transactions is limited, Table 1 only shows values for IPOs, acquisitions, and SEOs.

counted for 41% of all acquisitions while pure stock acquisitions accounted for only 14%; the 'currency' argument, however, receives considerable support from the 708 acquisitions (45% of the total) that were completed by a combination of cash and stock.

Table 3.4.1-A: Annual Distribution of IPOs, Acquisitions, SEOs, and Divestitures

The total sample of 1,504 IPOs during the period 1995-2008 raised a total of £77.2 billion and involved in 1,587 acquisitions worth £38.1 billion, 915 SEOs raising 20.1 billion, and 436 divestitures. In total, the sample of IPO firms was involved in 2,938 corporate events in the three-year period after flotation, worth £58.3 billion, excluding the value of divestitures.

	IPOs		**Acquisitions**		**SEOs**		**Divestitures**		**All Events**	
Year	**No,**	**Amount Raised**	**No.**	**Value (£m)**	**No.**	**Value (£m)**	**No.**	**Value (£m)**	**No.**	**Value (£m)**
1995	11	53							-	-
1996	82	419	1	127	9	244	0		10	371
1997	53	273	2	1	12	92	1		15	93
1998	71	7,119	47	485	25	220	5		77	705
1999	77	10,951	98	668	32	270	21		151	939
2000	201	9,276	189	3,090	59	2,072	20		268	5,162
2001	78	4,891	170	1,503	35	957	53		258	2,460
2002	54	3,984	118	852	48	935	41		207	1,787
2003	50	2,586	61	3,536	31	1,437	33		125	4,973
2004	214	4,375	81	1,073	25	805	20		126	1,878
2005	261	8,471	168	3,126	68	1,932	39		275	5,058
2006	200	13,534	234	7,604	167	3,409	43		444	11,013
2007	144	11,096	273	5,043	225	4,235	69		567	9,278
2008	8	170	108	2,556	108	1,898	57		273	4,454
2009			22	6,696	47	1,066	23		92	7,762
2010			14	1,787	22	524	9		45	2,312

2011			1		2	23	2		5	23
All	**1,504**	**77,197**	**1,587**	**38,146**	**915**	**20,120**	**436**		**2,938**	**58,266**

* Data for the value of divestitures is not available.

Table 3.4.1-B provides summary statistics of the number of corporate events for each of the three years following an IPO. It is immediately apparent that each of the three types of corporate event follows a distinct timing pattern. In sharp contrast to divestitures, for example - almost half of which occur during the third year after flotation - 45% of the total number of acquisitions completed within the first 12 months and then gradually decline during the second (32%) and third years (23%). This pattern of activity is consistent with the notion that firms are indeed using public listing as part of a strategic move for growth through acquisitions. On the other hand, the broadly even distribution of SEOs across the three years suggests that firms raise additional equity at regular intervals in order to fund ongoing operations and possibly cash acquisitions.

Table 3.4.1-B: Annual Number of Events Announced by IPO Firms in the Three Years after Flotation

The total sample of 1,504 IPO firms during the period 1995-2008 was involved in 2,938 corporate events during the first 3 years since flotation. Acquisitions account for 54% of the total number of events (2,938) during 1995-2011, while SEOs and divestitures account 31% and 15% respectively. The majority acquisitions (45) occur within the first year of listing, while a larger number of divestitures (45%) take place in the third year since going public. SEOs are distributed evenly across the 3 years.

	YEAR 1	**YEAR 2**	**YEAR 3**	**TOTAL**
Acquisitions				
Number	715	503	369	1,587
% of total by year	(45%)	(32%)	(23%)	(100%)
% of total by type	(67%)	(49%)	(43%)	(54%)
SEOs				
Number	274	346	295	915
% of total by year	(30%)	(38%)	(32%)	(100%)
% of total by type	(26%)	(34%)	(34%)	(31%)
Divestitures				
Number	71	168	197	436
% of total by year	(16%)	(39%)	(45%)	(100%)
% of total by type	(7%)	(17%)	(23%)	(15%)
All				

Number	1,060	1,017	861	2,938
% of total by year	(36%)	(35%)	(29%)	(100%)
% of total by type	(100%)	(100)	(100)	(100%)

3.4.2. Volume, Pattern and Timing of Follow-on Corporate Events

Table 3.4.2-A provides details on the pattern and timing of corporate events by IPO firms during the three-year period following flotation. First, it is worth noting that out of total of 1,504 IPOs, only 1,277 were still listed at the beginning of the third year; a sizable proportion (15%) of the original sample were delisted either voluntarily, i.e. as a result of transfer to the Main market, a merger, going private again or bankruptcy. More specifically, the table shows the number and proportion of IPO firms that were involved in each of the three types of corporate events during the first six months and at one, two, and three years after flotation. The percentage estimates are based on the number of live IPO firms at the end of each of the four periods. For example, 625 IPO firms, or 49% of those still alive at the end of the three-year period, were not involved in any acquisitions. On the other hand, 652 (51% of the surviving IPO firms) made at least one acquisition within the three-year period, while 124 (10% of the surviving) made at least four.

Acquisitions clearly emerge as the most popular type of activity, particularly within 12 months of flotation; a total of 28% and 41% of the IPO companies in the sample had at least one such event within first 12 and 24 months, respectively, and by the end of the third year, more than half (51%) had concluded one such transaction. However, although the pattern of post-IPO acquisition activity in the UK is broadly comparable to the US, the average number of takeovers per IPO is still lower. Celikyurt, Sevilir and Shivdasani (2010), for example, report that 54.7% of IPO firms in the US conduct at least one acquisition within the first year and 71.5% within three years. Moreover, while they find that the average number of acquisitions during the first IPO year is 0.65, increasing to 3.35 by the end of the third year, the equivalent average level of acquisition activity in UK is 0.48 for the first year, increasing to 1.04 by the third year. Their sample, however, includes only 1,295 IPOs with total proceeds equal to or greater than $100 million. Hovakimian and Hutton (2010a), on the other hand, using a larger sample of 5,771 IPOs that includes smaller companies and a longer time period, find that only 19% and 36% of the IPO firms in their sample completed at least one acquisition by the first and third years of their IPO, respectively. This is a level of activity considerably lower than the equivalent 28% and 51% rates levels of activity we report for UK. They also find that the average number of acquisition per IPO is just 0.74, considerably lower than in UK.

SEOs start relatively slowly, with only 17% having an additional equity issue in the first 12 months, but their frequency grows rapidly during the second and third years. In fact, by the end of the third year, 50% of the surviving IPO firms had raised additional equity through at least one SEO, a proportion almost identical to those involved in a least one acquisition; a further 17% and 4% of the surviving IPOs had 2 or 3 SEOs respectively by the third year of listing. Overall, however, the average number of SEOs from our original sample of IPOs is only 0.6 in comparison to 1.04 acquisitions per IPO. The pattern of SEO activity in our sample is consistent with Hovakimian and Hutton (2010b), who use a broader sample of equity issues not related to IPOs only, finding that 50% of the issues are by firms that issue only once, 26% by those issuing twice and 13% three times. The slow start and subsequent gradual increase in the number of SEOs could be related to the emerging need for funds for further acquisitions and capital expenditure but could also be related to recent price movements. The table also shows that a remarkable 77% of the surviving sample IPO companies did not

complete a single divestiture during the three-year period. Only 4% made a divestiture within the first year of listing but, although their popularity increased gradually over time, only 23% of the IPO firms still alive at the beginning of the third year were involved in at least one such event by the end of the three-year period. Finally, it is worth noting that the overall volume of acquisitions and SEOs in our sample of IPOs is very similar to the equivalent level of activity across Europe (Vismara, Paleari and Ritter 2012).

Table 3.4.2-A: Summary Statistics of Corporate Events Following an IPO

The sample of 1,504 IPOs, during the period 1995-2008 were, involved in different types of corporate events in the three years following flotation. An event can be an acquisition, an SEO or a divestiture during the first six, 12, 24 and 36 months. A total of 227 IPOs, 15% of the initial sample, were delisted by the end of the three-year period since flotation, and about 50% of initial sample of IPOs by the end of the 3-year period were not involved in any acquisitions or SEOs; a large proportion of the IPOs (77%) were not involved in any divestitures. Overall, during the 3-year period in the aftermarket only 17% were not involved in any type of corporate event, while a small minority of 10%, 1% and 2% were involved in more than 4 acquisitions, SEOs and divestitures respectively.

	Months 0-6		**Years 0-1**		**Years 0-2**		**Years 0-3**	
	No	%	No	%	No	%	No	%
Total no. of IPOs	1504							
End of Period: IPOs	1495	99%	1475	98%	1388	92%	1277	85%
Delisted IPO firms	9	1%	29	2%	116	8%	227	15%
IPO firms making no:								
Acquisitions	1253	84%	1069	73%	824	59%	625	49%
SEOs	1378	92%	1225	83%	887	64%	632	50%
Divestitures	1465	98%	1450	98%	1225	88%	977	77%
Events at all	1162	78%	889	60%	484	35%	213	17%
IPO firms making at least one:								
Acquisition	242	16%	406	28%	564	41%	652	51%
SEO	117	8%	250	17%	501	36%	645	50%
Divestiture	30	2%	58	4%	163	12%	280	22%
IPO firms making at least two:								
Acquisitions	69	5%	155	11%	267	19%	344	27%
SEOs	5	0%	23	2%	106	8%	215	17%
Divestitures	2	0%	10	1%	42	3%	80	6%
IPO firms making at least three:								
Acquisitions	24	2%	73	5%	143	10%	204	16%
SEOs	0	0%	1	0%	11	1%	48	4%
Divestitures	0	0%	3	0%	15	1%	38	3%
IPO firms making at least four:								
Acquisitions	9	1%	34	2%	85	6%	124	10%
SEOs	0	0%	0	0%	2	0%	7	1%

Divestitures	0	0%	0	0%	8	1%	19	1%

Table 3.4.2-B, in the broad shape of a decision tree, offers a different perspective on post-IPO corporate activity by tracing the pattern of the first three post-IPO corporate events. For each step, there are five options: acquisition, divestiture, SEO, no event, or delisting. The first event for 500 (33%) of the total 1,504 IPO firms in the initial sample was an acquisition, 29% an SEO, and 9% a divestiture. At the same time, 87 firms (5%) were delisted before they had undertaken any corporate activity, while almost a quarter (353 firms or 24%) of the whole sample was not involved in any corporate activity during the first three years of public life.

The table also shows that 46% of firms (230) with an acquisition as their first event followed it up with a second acquisition, while 52% (122) even made a third acquisition during the three-year period following flotation. At the same time, 19% of the IPO firms starting with an acquisition as their first corporate event followed it up with an SEO and then either switched to yet another acquisition (36%), opted for a divestiture (4%), or proceeded with another SEO (16%). We also observe a broadly similar interchanging pattern for IPO firms starting with an SEO or a divestiture as their first event. For example, 435 of IPO firms (29% of the total), raised additional equity as their first corporate event; 25% of these followed it up with a second fundraising round and 19% even had a third one. At the same time, a sizable proportion (23%) probably used at least some of the proceeds of their first SEO for an acquisition as their second event.

Overall, the evidence suggests that the type of the first corporate event sets the pattern for the follow-on activities. For example, more than half of the IPO firms starting with an acquisition are involved in more acquisitions as their second and third events. Moreover, 54% of IPO firms starting with a divestiture are also more likely to be involved in two more such transactions later on. A broadly similar, but with less pronounced pattern, is also observed for SEOs. Such repetitive patterns of the same type of event may be related to positive market feedback and subsequent positive performance, as reported for SEOs by Hovakimian and Hutton (2010b), or may be part of a predefined strategic plan for growth. We explore the potential implications of such patterns of serial behavior on long-term performance in Section V. Finally, it is worth noting that a total of 28 firms – 7.2% of the surviving firms - were delisted after completing three events.

Table 3.4.2-B: Patterns of Post-IPO Corporate Event Activity

This table illustrates the pattern of corporate events for the 1,504 newly listed firms. After listing, there are five possible options: acquisition, SEO, divestiture, no event, or delisting. Delisting incorporates bankruptcy, delisting and takeover. Each option is available three consecutive times, Event 1, Event 2, and Event 3. The table therefore becomes a decision tree illustration in that each event step (1-3) shows the number of firms following a given path of the five options available. The numbers in brackets corresponds to the number of firms following the given path together with the corresponding probability for the sample.

	Event 1	Event 2	Event 3
1,504 IPOs			
			Acquisition (122; 52%)
		Acquisition (230; 46%)	SEO (28; 12%)
			Divestiture (21; 10%)
			No event (55; 24%) Delist (4; 2%)
			Acquisition (35: 36%)
	Acquisition (500; 33%)	SEO (95; 19%)	SEO (15; 16%)

			Divestiture (4; 4%)
			No event (37; 40%) Delist (4; 4%)
			Acquisition (8; 20%)
		Divestiture (27; 16%)	SEO (3; 13%)
			Divestiture (5; 16%)
		No event (121; 24%) Delist (27; 5%)	No event (8; 32%) Delist (3; 13%)
			Acquisition (36; 34%)
		Acquisition (106; 24%)	SEO (24; 23%)
			Divestiture (5; 5%)
			No event (34; 32%) Delist 7; 6%)
			Acquisition (18; 16%)
	SEO (435; 29%)	SEO (111; 25%)	SEO (21; 19%)
			Divestiture (6; 5%)
			No event (62; 56%) Delist (4; 4%)
			Acquisition (4; 11%)
		Divestiture (34; 8%)	SEO (5; 15%)
			Divestiture (9; 26%)
		No event (160; 37%) Delist (28; 6%)	No Event (12; 37%) Delist (4; 11%)
			Acquisition (6; 38%)
		Acquisition (16; 12%)	SEO (3; 18%)
			Divestiture (1; 6%)
			No event (6; 38%) Delist (0; 0%)
			Acquisition (0; 0%)
	Divestiture (129; 9%)	SEO (29; 22%)	SEO (4; 14%)
			Divestiture (7; 24%)
			No event (17; 59%) Delist (1; 3%)
			Acquisition (0; 0%)
		Divestiture (25; 20%)	SEO (0; 0%)
	No event (353; 24%)		Divestiture (13; 54%)
	Delist (87; 5%)	No event (45; 36%) Delist (14; 10%)	No event (11; 42%) Delist (1; 4%)

3.5. The Likelihood of an Acquisition, SEO or Divestiture

In this section we investigate the firm and market characteristics related to each of the three types of corporate events. Table 3.5-A presents summary statistics on the size and key operating characteristics for our sample of IPOs, in both the Main and AIM markets, by the type of their first corporate event and for the group of IPO firms without any corporate activity during the three years after flotation. More specifically, it reports the median values for underpricing, market value, and equity proceeds as well as a number of key performance indicators. In general, we find no fundamental differences in the characteristics of the IPO firms involved in different types of corporate event; this applies to firms in both the Main and AIM markets, in spite of the obvious differences in the absolute values of their size-related characteristics. There are, however, some subtle differences between corporate-event active and inactive IPO firms. The latter group, for example, consists of relatively larger firms in terms of assets and sales, which are more profitable, at least in the Main market, both in absolute and relative terms, and operating in more mature industries as indicated by their assets' tangibility.

On the other hand, recently listed firms involved in acquisitions and SEOs are relatively smaller in terms of sales and somewhat less profitable.

Table 3.5-A: Operational characteristics for the IPO Firms at the Time of Listing

The table reports key operational characteristics for the sample of 1,504 IPOs, in the Main and AIM, during the period 1995-2007 according to the type of their first corporate event since flotation. The source of data for all balance items are the IPO prospectuses and are based on the last published accounts before going public. The number of observations varies across items depending on data availability.

	Acquisitions				**SEOs**		**Divestitures**		**No Event**			
	Cash		**Stock**		**Hybrid**							
	Main	**AIM**	**Main**	**AIM**	**Main**	**AIM**	**Main**	**AIM**	**Main**	**AIM**	**Main**	**AIM**
Underpricing												
Median	8%	10%	10%	9%	8%	10%	8%	8%	8.3%	7.7%	9%	7.3%
No. Obs.	80	256	18	129	59	274	89	489	55	184	54	355
MV at offer(£m)												
Median	430	20	535	13	204	16	490	19	674	22	157	17
No. Obs.	98	268	22	149	68	291	114	531	82	198	67	373
IPO Proceeds(£m)												
Median	94	5	67	3	64	4	115	4	188	6	54	5
No. Obs.	98	268	21	149	67	290	112	530	81	198	67	373
Total Assets(£m)												
Median	104	10	48	5	63	7	147	7	266	9	59	6
No. Obs.	88	266	21	146	65	286	107	521	68	190	64	357
Sales(£m)												
Median	104	10	48	5	63	7	147	7	266	9	59	6
No. Obs.	88	266	21	146	65	286	107	521	68	190	64	357
EBITDA(£m)												
Median	12	0.6	2	-0.1	5	0.1	19	-0.3	27	-0.2	4	0.04
No. Obs.	88	231	19	128	62	249	104	464	165	169	63	309
IPO Proceeds / TA												
Median	63%	56%	104 %	67%	86%	54%	63%	71%	49%	57%	82%	77%
No. Obs.	85	263	15	139	63	274	102	495	66	181	60	340
Sales/TA												
Median	94%	68%	70%	18%	47%	60%	71%	18%	67%	18%	68%	38%
No. Obs.	82	219	19	119	59	232	99	448	66	164	54	284
Leverage (TD/TA)												
Median	15%	7%	14%	18%	5%	6%	14%	3%	15%	3%	13%	3%
No. Obs.	87	232	20	123	63	249	106	456	65	166	62	296
Cash /TA												
Median	15%	19%	55%	28%	26%	22%	18%	33%	12%	22%	18%	28%
No. Obs.	84	219	18	119	61	238	103	437	63	163	61	271
Tangibility /TA												
Median	18%	8%	7%	7%	8%	6%	19%	7%	18%	7.5%	26%	8%
No. Obs.	85	217	19	112	54	234	104	421	64	159	61	269
EBITDA to Sales												
Median	16%	7%	8.2%	-8.3%	13%	4%	17%	-18%	16%	-0.8%	11%	4.4%
No. Obs.	88	209	19	128	62	235	100	346	63	132	62	265
EBITDA/TA												
Median	15%	7%	-1.3%	-9%	12%	1.4%	-8%	-7%	11%	-4%	13%	1%
No. Obs.	88	231	22	149	62	249	104	463	65	169	63	308

We use logit panel regressions to assess separately the likelihood of an acquisition – financed either by cash, stock or mixed – SEO, and divestiture as a function of company-specific characteristics and market conditions. In the logit regression (2) below, the dependent variable is set to one when there

is an event during each of the six-month interval within the three years since going public or 0 otherwise. Thus, the same IPO firm may be included in any of the six logit regressions if it was involved in different types of event during that period.

$$A_{it} = a_i + \beta_1 Timing + \beta_2 IPOProceeds + \beta_3 EquityProceeds(-6M) + \beta_4 Profitability(-1Y) + \beta_5 Leverage(-1Y) + \beta_6 Tangibility(-1Y) + \beta_7 Return(-3M) + \beta_8 MarketSentiment(-3M) + B_9 GDPGrowth(-6M) + \beta_{10} FDR + \beta_{11} PreviousEvent(-1) + \beta_{12} Market + \beta_{13} Sales(-1Y) + \varepsilon_{it} \quad (2)$$

The independent variables relate to the three hypotheses while company characteristics are used as control variables. According to the financing hypothesis, the probability of acquisition increases with the availability of IPO proceeds (money raised at flotation scaled to total assets), the proceeds of previous equity issues (equity raised scaled to total assets), profitability (EBITDA scaled to total assets), leverage (total debt scaled to total assets) and asset tangibility (property plant and equipment scaled to total assets). On the other hand, the probability of acquisition declines with the time period lapsed since the IPO (the number of six-month intervals since the IPO).

The market timing hypothesis posits that the likelihood of stock acquisitions increases with recent stock price performance, market sentiment (the average discount of investment trusts over a three-month period before the event) and general economic conditions (GDP growth over the previous six months). First day returns (underpricing) could also be an important determinant of acquisition activity, either as an indicator of market feedback or as another proxy for market misevaluation. We also include a dummy variable to control for the occurrence of a previous similar event as a proxy of reduced adverse selection costs and an indication of an established strategic plan for future growth; our set of control variables also includes the listing market (Main or AIM) and a log of sales as a proxy for size.

Table 3.5-B reports the logit regressions for each of the three main corporate events and separate results for acquisitions according to the method of payment, i.e. cash, stock, and hybrid. It is worth noting that the market timing and feedback hypotheses are to a certain extent relevant for all three types of events while the financing hypothesis relates to acquisitions and SEOs only. More specifically, we find a negative and significant coefficient for timing across all types of acquisitions and SEOs, suggesting that an early engagement in such transactions is indicative of a pre-planned strategy for future growth. Divestitures, on the other hand, take place later in public life suggesting that such events are in response to firm performance and market conditions rather than part of a predefined plan. In contrast to Hovakimian and Hutton (2010a) and Celikyurt, Sevilir and Shivdasani (2010), who report a positive and significant coefficient for cash acquisitions, we find positive but not significant coefficients suggesting that IPO proceeds are not the dominant source of funds for acquisitions. Instead, our evidence demonstrates strong support for the financing hypothesis in terms of the positive and significant coefficient of the additional equity proceeds for cash and hybrid acquisitions; thus, recent IPO firms use their public status to raise additional equity capital (SEOs) to fund cash and mixed acquisitions. Stock acquisitions of course also use their public listing to generate currency for acquisitions, as suggested by Brau and Fawcett (2006)'s CFOs' survey. The positive and significant profitability coefficient for cash acquisitions suggests that internally generated funds are another important source of finance for cash and hybrid acquisitions. On the other hand, the corresponding negative coefficient for SEOs and divestitures indicate that such corporate events are more likely to be motivated by the need for some type corporate restructuring to address their poor profitability at that point in time. Klein and Rosenfeld (2010), for example, find that poor performance and underinvestment in subsidiaries are the key motivations for spin-offs and the subsequent improvement in the parents' performance.

There is also considerable evidence in support of both the market timing and market feedback hypotheses across all three types of corporate event. In contrast to Hovakimian and Hutton (2010a), we find that only stock acquisitions are affected by market timing exactly as predicted by the market timing hypothesis. The probability of stock acquisitions and SEOs, for example, is significantly higher for issuers with strong recent price performance and in the case of stock and hybrid acquisitions for IPO companies with a particularly successful market debut in terms of first day performance. Celikyurt, Sevilir and Shivdasani (2010) also report that firms with higher first day returns conduct more stock-financed acquisitions in the years following an IPO. Further support for the importance of market timing in post-IPO corporate activity is offered by the positive and significant coefficients of market sentiment, as measured by the average investment trusts' discount for cash acquisitions, SEOs and even divestitures. An additional perspective on the strategic motivation behind acquisitions and SEOs is offered by their respective positive and negative coefficients for GDP growth. They indicate that acquisitions are a direct response to an expanding economy while SEOs are more likely to be launched in response to capital requirements, either for acquisitions or capital expenditure, at times of sluggish economic growth.

Consistent with the pattern of follow-on events shown in Table 3.4.2-B, the logit results also point to a strong serial pattern of follow-on corporate events by companies which have carried out recent IPOs. The positive and significant coefficients of a recent acquisition, SEO or divestiture suggest a recurring pattern in such transactions that are likely to be indicative of a long-term plan for future growth; such a pattern also provides further support to the market feedback hypothesis through closer monitoring and reductions in potential information asymmetries. Intintoli, Jategaonkar and Kahle (2011) find that firms that issue SEOs within the first year of their IPO are able to offer shares at a smaller discount as institutional demand is significantly higher for follow-on SEOs. .

Table 3.5-B: The Likelihood of an Acquisition, SEO, or Divestiture

The Table reports estimates from logit panel regressions where the dependent variable is a dummy variable which takes the value of '1' if there is an event during the six months period and '0' otherwise. *Timing* is the number of six-month time intervals since the IPO. *IPO Proceeds* is the money raised scaled to total assets. *Equity proceeds* is the primary equity capital (SEO) raised in the six-month period scaled to total assets. *Profitability* is EBITDA scaled to total assets of the latest available in the calendar year six months prior (LACY-6M). *Sales* is the logarithm of revenues (LACY-6M). *Leverage* is the total debt scaled to total assets (LACY-6M). *Tangibility* is property plant and equipment scaled to total assets (LACY-6M). *Return* is the three-month share price return prior to the six-month period. *Underpricing* is the difference between the offer price and the first day of trading, scaled by the offer price. *Previous Event* is a dummy equal to '1' if a similar event has taken place in the six months prior and '0' otherwise. The proxy for *Market Sentiment* is the average three-month investment trust discount prior to the six-month period. *GDP Growth* is the quarterly UK GDP growth in the quarter prior to the six-month period. The dummy variable for *Market Listing* takes the value of '1' if listed on the Main market and '0' otherwise. Positive coefficients imply that increases in the variable are associated with higher probability of an event. The statistics reported in brackets are the Z statistics. The Pseudo-R^2 is the log-likelihood of the maximum likelihood minus the log-likelihood when only the constant is included. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

	All Acquisitions	**Cash Acquisitions**	**Stock Acquisitions**	**Hybrid Acquisitions**	**SEOs**	**Divestitures**
Timing	-0.091 (-8.96)***	-0.071 (-6.21)***	-0.136 (-2.40)**	-2.229 (-6.18)***	-0.094 (-3.80)***	0.273 (5.74)***
IPO Proceeds	-0.024 (-1.68)*	0.002 (0.16)	0.012 (0.162)	-0.166 (-2.41)**	-0.071 (-1.68)*	-0.016 (-0.22)
Equity Proceeds	0.332 (5.34)***	0.186 (3.48)***	0.348 (1.89)*	0.672 (5.41)***		-0.216 (-0.89)
Profitability	0.183 (3.23)***	0.258 (3.44)***	-0.298 (-1.29)	0.402 (1.97)**	-0.383 (-3.12)***	-0.664 (-3.58)***

Sales	0.031 (3.71)***	0.047 (4.71)***	-0.063 (-1.46)	0.038 (1.42)	-0.026 (-1.18)	0.116 (2.60)***
Leverage	0.038 (0.67)	0.045 (0.72)	0.029 (0.11)	0.208 (1.22)	-0.190 (-1.18)	0.465 (2.31)**
Tangibility	-0.335 (-4.46)***	-0.210 (-2.51)**	-0.604 (-1.53)	-1.615 (-5.01)***	0.370 (1.99)**	0.057 (0.17)
-3M Return	0.0836 (2.04)**	0.081 (1.84)*	0.348 (2.17)**	-0.011 (-0.08)	0.356 (4.21)***	0.119 (0.71)
Underpricing	0.086 (3.03)**	0.039 (1.33)	0.233 (2.34)**	0.119 (1.58)	-0.040 (-0.01)	0.227 (2.39)**
Previous Event	0.531 (11.82)***	0.362 (7.75)***	0.575 (2.69)***	1.232 (10.59)***	0.314 (2.64)***	0.041 (0.19)
Market Senti-ment	1.669 (3.28)***	1.331 (2.34)**	-1.480 (-0.53)	7.176 (4.13)***	7.22 (5.09)***	4.04 (1.79)*
GDP Growth	6.253 (2.55)***	2.659 (0.94)	9.506 (0.72)	9.20 (3.12)***	-21.92 (-3.58)***	1.88 (0.19)
Market Listing	0.034 (0.77)	0.063 (1.30)	0.034 (0.13)	-0.013 (-0.85)	0.181 (1.59)	0.66 (3.51)***
Intercept	-0.818 (-5.62)***	-1.414 (-7.80)***	-3.909 (-5.81)***	-2.070 (-5.15)***	-0.959 (-2.31)**	-6.69 (-5.85)***
R-squared	0.099	0.092	0.034	0.126	0.025	0.072
Observations	7059	7059	7059	7059	7059	7059

Finally, in line with Hovakimian and Hutton (2010a), we find that the likelihood of cash acquisitions increases with size as larger firms have better access to both debt and equity markets due to their greater transparency and lower risk. Larger firms are also more likely to hold more extensive cash reserves and are in a better position to fund their acquisitions by cash; stock acquisitions, on the other hand, are not affected by size. Rather surprisingly, we find that leverage is only related to divestitures but not to the decision to pursue acquisition or SEOs; divestitures are also more likely among firms listed on the Main market.

We also investigate the likelihood of each of the events occurring in each of the three post-IPO years separately. Further unreported results suggest that the positive and significant coefficient of under-pricing for stock and hybrid acquisitions is entirely due to the acquisitions which take place in the first 12 months post-IPO; such corporate events in the second and third years are not related to first-day performance. Also, the positive coefficient of market growth, found in the overall three-year results, is predominantly driven by the acquisitions which take place in the second year only. Otherwise, the annual logit regressions show remarkable persistence for all types of corporate event for each of the three years following an IPO.

3.6. Aftermarket Performance

To assess the potential relationship between follow-on corporate activities and the long-term performance of IPO firms, we estimate BHARs for the sample as a whole, by the market of listing (Main vs. AIM) and a number of strategies reflecting the volume of corporate events of any type during the three-year period after flotation. Table 3.6-A reports BHARs for the whole sample of IPO companies from January 1995 to March 2008 calculated until the earlier of either the IPO's third anniversary or the delisting date; the latest date for returns was April 2011. We report results for the first six months and then at 12-month intervals, excluding first-day returns, using two alternative benchmarks: 1) the

FTSE All-Share Index and 2) the ten FTSE sector indices. The number of IPOs included in the calculation of BHARs declines with the month of seasoning. Panel A reports equal- and value-weighted BHARs for all IPOs, while Panels B and C show separate results for the Main and AIM markets, respectively. We also report performance results for all IPO firms and three alternative strategies reflecting their follow-on corporate activities, i.e. no events, at least one event, and at least two events during the three-year period after the listing; event(s) refers to a single or a combination of any of the three types of corporate activity examined in this paper.

The results for the entire sample of IPOs in Table 3.6-A (Panels A and B) are broadly consistent with the pattern of previous US and UK studies. The equally-weighted 36-month BHARs, both FTA- and industry-adjusted, are negative and statistically significant, confirming once again the long established pattern of long-term average underperformance, while the equivalent positive but non-significant value-weighted returns suggest that firm size plays some role in long-run performance. Follow-on corporate activity, however, emerges as the decisive discriminating factor for long-term performance. The average equally-weighted 36-month return for all IPOs without any follow-on activity drops to -33.80% in comparison the average of -12.80%; on the other hand, the equivalent FTA-adjusted returns for IPO companies with at least one or two corporate events are not statistically significant from zero. A broadly similar pattern is also evident for value-weighted FTA- and industry-adjusted returns.

Panels B and C provide further detail on the issues of firm size and listing market by examining the 36-month performance of IPOs on the Main (Panel B) and AIM (Panel C) markets separately. While, for example, the average equally- and value-weighted 36-month BHARs for firms on the Main market are not statistically different from zero, IPO firms on AIM significantly underperform both the relevant market and industry benchmarks by 16.47% and 34.72% respectively during the same time window; the value-weighted returns are also very similar. At the same time, however, it is worth noting some of the performance differences across firms depending on the basis of their follow-on corporate activities. We find, for example, that the industry-adjusted BHARs for IPO companies with one or two follow-on events on the Main market are positive and significant. Moreover, in contrast to the negative and significant equal and value BHARs for IPO firms without any follow-on events on AIM, the equivalent performance of active firms (two or more events) is not statistically different from zero.

Table 3.6-A: Buy-and-Hold Abnormal Returns by Volume of Activity

The total sample of 1,504 IPOs during the period 1995-2008 were involved in a total of 2,938 corporate during the first 36 months of going public; this include 1,587 acquisitions, 915 SEOs and 436 divestitures. For each IPO, the buy-and-hold returns are calculated by compounding daily returns up to the month of the IPO and from the on compounding monthly returns for 36 months. Buy-and-hold returns (BHARs) in panel A include IPOs both in the Main and AIM markets and are calculated using the FTSE-All Share index for IPO firms in the Main market and the FTSE Small-Cap index for their AIM counterparts; Industry adjusted BHARs are based on the FTSE 10 Group Industry Classification indices.. Panels B and C show the equivalent BHARs for IPOs in the Main and AIM markets respectively. Each of the three panels shows BHARs for all IPOs in the respective market(s) and separate estimates according to the number of corporate events for each IPO during the 3 years in the aftermarket; a corporate even could be either an acquisition, an SEO or a divestiture. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

Panel A: All IPOs

Equal Weighted

FTA Adjusted					Industry Adjusted				
Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2

6	1.20 (-0.60)	-5.85 (-0.84)	0.72 (0.46)	1.75 (0.93)	6	-1.98 (-0.97)	-4.92 (-0.74)	-0.76 (-0.43)	0.49 (0.27)
12	-9.19*** (-4.42)	-21.32*** (-6.45)	-4.24* (1.74)	-1.71 (0.64)	12	-11.84*** (-5.55)	-22.44*** (-6.81)	-7.51*** (-2.99)	-4.55* (-1.74)
24	-17.34*** (4.42)	-35.36*** (-4.79)	-10.55*** (2.43)	-6.73 (-1.27)	24	-24.80*** (-5.89)	-44.83*** (-6.58)	-17.25*** (-3.71)	-11.54** (-2.12)
36	-12.80** (2.31)	-33.80*** (-3.98)	-5.16 (-0.81)	-5.57 (0.75)	36	-26.52*** (-3.78)	-50.54*** (-5.92)	-17.78*** (2.43)	-15.98* (-1.86)

Value Weighted

FTA Adjusted					Industry Adjusted				
Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2
6	5.57 (1.16)	-1.15 (0.01)	6.66 (1.21)	13.05** (2.16)	6	6.63 (1.41)	-0.90 (-0.28)	7.38** (1.40)	13.08** (2.20)
12	-7.05* (-1.75)	-23.71*** (-6.05)	-4.82 (-1.07)	-2.71 (-0.53)	12	-4.52 (-1.27)	-19.21*** (-5.16)	-2.56 (-0.65)	-0.63 (-0.13)
24	-1.57 (-0.15)	-26.21*** (-6.82)	1.51 (0.23)	-6.38 (0.73)	24	0.97 (0.19)	-21.11*** (-6.88)	3.84 (0.58)	9.22 (1.21)
36	0.45 (0.15)	-19.93*** (-3.42)	2.76 (0.40)	4.90 (0.58)	36	0.82 (0.17)	-19.80*** (-3.13)	3.15 (0.43)	5.24 (0.60)

Panel B: Main

Equal Weighted

FTA Adjusted					Industry Adjusted				
Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2
6	2.83 (1.06)	-9.29* (1.88)	6.59** (2.19)	8.29*** (2.50)	6	2.83 (1.06)	-9.29* (-1.88)	5.99** (2.02)	7.95*** (2.35)
12	-4.85 (-1.18)	-24.20*** (3.16)	1.26 (0.30)	3.61 (0.71)	12	-4.85 (-1.18)	- 24.20*** (-3.16)	1.12 (0.28)	3.35 (0.69)
24	5.07 (0.70)	-17.16 (-1.44)	11.06 (1.28)	17.18* (1.79)	24	5.07 (0.70)	-17.16 (-1.44)	14.71* (1.87)	20.69*** (2.46)
36	3.13 (0.47)	-17.96 (-1.58)	8.93 (1.09)	10.00 (1.14)	36	3.13 (0.47)	-17.96 (-1.58)	14.64* (1.94)	16.14** (2.04)

Value Weighted

FTA Adjusted					Industry Adjusted				
Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2
6	8.43 (1.54)	-1.19 (0.22)	9.15 (1.55)	14.16** (2.16)	6	8.43 (1.54)	-1.19 (0.22)	9.68* (1.69)	14.10** (2.19)
12	-5.73 (-1.26)	- 26.91*** (-4.77)	-3.54 (-0.72)	-3.06 (-0.55)	12	-5.73 (-1.26)	- 26.91*** (-4.77)	-1.64 (-0.37)	0.75 (0.14)
24	1.56 (0.23)	- 21.22*** (-3.59)	3.82 (0.47)	7.21 (0.76)	24	1.56 (0.23)	- 21.22*** (3.59)	6.33 (0.85)	10.72 (1.30)
36	3.10 (0.44)	-14.23* (-1.68)	4.65 (0.58)	5.60 (0.61)	36	3.10 (0.44)	-14.23* (-1.68)	5.84 (0.69)	7.08 (0.74)

Panel C: AIM

Equal Weighted

FTA Adjusted	Industry Adjusted

Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2
6	-2.09 (-0.86)	-5.25 (-0.68)	-0.71 (0.35)	-0.07 (-0.01)	6	-3.33 (-1.29)	-5.44 (-0.70)	-2.39 (-1.17)	-0.07 (-0.01)
12	-10.16*** (-4.23)	-20.81*** (-5.74)	-5.58* (-1.95)	-3.19* (-1.05)	12	-13.88*** (-5.47)	-23.81*** (-6.34)	-9.61*** (-3.19)	-3.19 (-1.05)
24	-22.39*** (-5.34)	-38.40*** (-4.23)	-15.94*** (3.39)	-13.52*** (-2.35)	24	-32.56*** (-6.92)	-50.77*** (-6.01)	-25.22*** (-4.80)	-13.52*** (-2.35)
36	-16.47*** (2.38)	-36.63*** (-3.62)	-8.69 (-1.11)	-10.08 (-1.06)	36	-34.72*** (-3.54)	-57.53*** (-5.47)	-25.91*** (-2.59)	-10.08 (-1.06)

Value Weighted

FTA Adjusted					Industry Adjusted				
Month	All IPOs	No Event	At least 1	At least 2	Month	All IPOs	No Event	At least 1	At least 2
6	-11.16** (-2.00)	-6.20 (-1.62)	-12.97* (-1.67)	0.51 (0.11)	6	-9.61** (-2.11)	-6.30 (-1.50)	-10.82* (-1.72)	0.51 (0.11)
12	-15.27*** (-2.56)	-16.70*** (-2.88)	-14.75* (-1.71)	1.63 (0.35)	12	-12.37*** (-4.30)	-19.67*** (-3.64)	-9.70*** (2.32)	1.63 (1.35)
24	-22.77*** (-5.73)	-38.23*** (-10.08)	-17.52*** (-2.90)	-4.25* (-0.57)	24	-24.13*** (5.16)	-46.16*** (-12.32)	-16.64*** (-3.04)	-4.25 (-0.57)
36	-18.65*** (-3.59)	-34.06*** (-4.26)	-13.79* (-1.95)	4.54 (0.47)	36	-27.48*** (-4.42)	-50.15*** (-6.62)	-20.33*** (-2.86)	-4.54 (-0.47)

In Panels A and B of Table 3.6-B, we present the Fama and French (1993) three-factor model results based on monthly returns. The intercept of the time series regressions provides an estimate of the risk-adjusted performance of each of the three groups of IPO companies according to their follow-on corporate activity. Their positive and significant values for both equally- and value-weighted returns suggest that IPO firms with two follow-on events generate an average market-adjusted return of about 9% per annum.

Table 3.6-B: Fama and French Three-Factor Regressions on Calendar-Time Monthly Portfolio Returns

The total sample of 1,504 IPOs during the period January 1995 to March 2008 were involved in 2,938 corporate during the first 36 months of going public; this include 1,587 acquisitions, 915 SEOs and 436 divestitures. RMF is the market return on the FT All-Share Index minus the risk-free rate that is the UK one month Treasury bill rate. SMB is the difference each month between the return of small and big firms. HML is the difference each month between the return on a portfolio of high book-to-market stocks and the return on a portfolio of low book-to-market stocks. The White heteroskedasticity robust t-statistics are reported in parenthesis. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

	All	**No Event**	**At least 1 Event**	**At least 2 Events**
Panel A: Equally-Weighted				
Intercept	0.015 (1.15)	-0.002 (-0.626)	0.023 (1.20)	0.007 (2.33)**
RMRF	1.917 (3.05)***	1.186 (9.45)***	2.214 (2.49)***	1.392 (13.1)***

SMB	0.961 (3.71)***	1.150 (5.12)***	0.887 (0.01)	1.191 (7.46)***
HML	-0.178 (-0.66)	-0.115 (-0.75)	-0.140 (-0.39)	-0.614 (-4.02)***
Adjusted R^2	0.801	0.538	0.510	0.651
Panel B: Value-Weighted				
Intercept	0.113 (1.03)	0.015 (1.13)	0.134 (1.03)	0.009** (1.98)
RMRF	6.616 (1.28)	1.274 (6.72)***	7.672 (1.24)	1.540 (10.33)***
SMB	-1.107 (-0.57)	1.251 (1.89)**	-1.448 (-0.62)	0.510 (2.44)**
HML	1.619 (0.77)	-0.231 (-1.07)	1.968 (0.78)	-0.237 (-1.56)
Adjusted R^2	0.093	0.091	0.072	0.507

Finally, to provide some further insights into the nature and drivers of aftermarket performance and their interaction with the pattern of follow-on corporate activity during the three years after flotation, Table 3.6-C reports multivariate regression results using the 36-month equally weighted buy-and-hold returns as the dependent variable. We relate aftermarket performance to a set of company-specific characteristics, such as market capitalization at the time of the offer, profitability in terms of EBITDA to total assets, and first-day returns. We also control for market sentiment, proxied by the discount on investment trusts, and the pattern of corporate event activity in terms of the timing, volume and composition of the follow-on acquisitions, SEOs and divestitures. More specifically, we differentiate between single events of any type and multiple events of the same type over the three-year time period and separate acquisitions according to their means of payment, i.e. cash, stock, or hybrids.

Table 3.6-C examines the relation between company specific characteristics and 36-month performance using the logarithm of wealth relatives. As expected, in model (1), we find a positive and significant relation between both market capitalization and profitability with long-term aftermarket performance, which is consistent with a number of other studies suggesting that the long-term underperformance of IPO firms is predominantly due to small and immature firms that are probably too eager for a public listing. It is also worth noting that underperformance is a generic feature of smaller IPO companies rather than those just listed on AIM. We also observe a negative and significant coefficient between market sentiment, in terms of investment trust discount, and 36-month performance; in other words, IPO firms floated in periods of positive market conditions clearly disappoint in the long term. Finally, the negative and significant coefficient for the no-event dummy suggests that IPO companies without any follow-on activities in terms of acquisitions, SEOs and divestitures underperform their active counterparts by the end of the three-year period.

Model (2) focuses on performance implications of early corporate activity. Consistent with the results of Brau, Couch and Sutton (2012), we find that IPO firms with at least one acquisition, of any type, within the first six months of listing perform significantly worse than average. On the other hand, in contrast to Levis (1995) and Jiang (2008), we find that there is a positive and significant relation between an SEO in the first six months of listing and long-run performance. At the same time, given the relatively limited divestiture activity at the early stages of public listing, it is not surprising that this type of activity is not related to long-term performance. Our results in model (3), however, suggest

that the underperformance of IPO firms with early acquisitions is more likely to be related to the timing rather than the nature of such acquisitions. The negative but not significant coefficient for IPO firms with at least two acquisitions of any type during the three-year period indicates that the long-term performance of acquiring firms is not significantly worse than the average IPO. The coefficient for SEOs, however remains positive and significant, confirming that IPO firms with at least two SEOs, with or without any other type of corporate event, perform better than their less active - in terms of raising equity capital - counterparts.

It is worth noting that in Table 3.4.2-B we show that a considerable number of recent IPO firms involved in an SEO as their first event are very likely to follow it up with an acquisition. In other words, a sizable proportion of the IPO firms raising additional equity capital are using at least part of the proceeds to pursue future cash acquisitions. Thus, the positive and significant coefficient for the "at least two SEOs" dummy during the 3-year period is likely to reflect the combined implications of SEOs and acquisitions on long-run performance. In some further unreported results, we also examine the performance of IPO firms involved in transactions of the same type only, but we find no evidence of a relationship between such 'clean' patterns of activity and 36-month performance. In the case of divestitures, there is very little difference between the performance of combined and clean transactions as the divesting IPO firms in our sample are less likely to be engaged in other types of corporate event during the three-year period.

Table 3.6-C: Multivariate Cross-Sectinal Regressions for 36-month Aftermarket Performance

The dependent variable is the natural logarithm of the 36-month wealth relative using the FTSE All-Share index as the market benchmark. The independent variables are the logarithm of Market Capitalization at the time of the IPO, *EBITDA/TA* is EBITDA scaled by total assets at the time of the IPO, the proxy for *Market Sentiment* is the average three-month investment trust discount at the time of the IPO. We use a dummy equal to 1 and 0 otherwise to capture the different types of corporate events during the first year and within three years of the public listing. The White heteroskedasticity robust t-statistics are reported in parenthesis. ***, **, and * indicate statistical significance at a 1%, 5%, and 10% level, respectively.

	(1)	**(2)**	**(4)**	**(3)**
Market Value	0.054** (2.43)	0.056** (2.46)	0.050*** (2.15)	0.045** (1.92)
EBITDA/TA	0.917*** (7.04)	0.931*** (7.17)	0.957*** (7.19)	0.935*** (7.08)
Market Sentiment	-6.476*** (-5.80)	-6.310*** (-5.64)	-6.79*** (-6.10)	-6.850*** (6.16)
No corporate events within 3 years	-0.158** (-1.96)			
At least one acquisition within the first six months		-0.291*** (-2.61)		
At least one SEO within the first six months		0.193* (1.89)		
At least one divestiture within the first six months		0.111 (0.53)		
At least two Acquisitions within three years			-0.078 (-0.85)	
At least two SEOs within three years			0.350*** (3.12)	
At least two divestitures within three years			0.099 (0.55)	
At least two cash acquisitions within three years				0.255* (1.78)

At least two stock acquisitions within three years				-0.543** (-1.98)
At least two hybrid acquisitions within three years				-0.042 (-0.37)
At least two SEOs within three years				0.353*** (3.20)
At least two divestitures within three years				0.103 (0.58)
Intercept	-1.511*** (-11.97)	-1.54*** (-12.31)	-1.602*** (-12.64)	-1.607*** (-12.65)
R2 adjusted	0.091	0.095	0.096	0.099
No. of observations	1,203	1,203	1,203	1,203

Our evidence so far appears inconsistent with a number of previous studies that report poor long-term performance for acquiring companies in general and recent IPO firms involved in subsequent acquisitions in particular. To shed some further light on this issue model (4) replicates the analysis of model (3) but separates acquisitions by method of payment, i.e. cash, stock, or hybrid. The results are quite revealing; while, for example, the coefficients for cash and hybrid acquisitions are non-significant, the coefficient for stock acquisitions is negative and significant suggesting that IPO firms that completed at least two such acquisitions, even if these were combined at some point with an SEO and/or divestiture, perform worse than other IPO companies. Thus, the apparent discrepancy of our results in model (3) with the evidence of Brau, Couch and Sutton (2012) for the US is likely to be related to the mix of cash and stock acquisitions in our respective samples. Our sample is broadly balanced between the two types of acquisition and thus the combined acquisitions dummy is not significant, whilst the negative relationship between performance and acquisitions in their sample is likely the result of a higher proportion of stock-based acquisitions in their sample. The method of payment may also account for the positive performance of European IPOs with subsequent acquisitions reported by Bessler and Zimmermann (2011).

Finally, it is important to note that our results are not directly comparable with any of the studies that focus on a single corporate event, i.e. acquisitions or seasoned equity offerings. Our evidence suggests that it is the overall pattern and timing of the three types of corporate event that relate to aftermarket performance than any single type of event on its own. Such a pattern of follow-on corporate events provides a more representative view of a firm's ability to pursue successfully its long-term strategic plan for future growth.

3.7. Conclusions

Using a sample of 1,504 IPOs listed in UK during the period January 1995 to March 2008, we track their follow-on corporate activities during the first 3 years of going public in terms of acquisitions, seasoned equity offerings and divestitures. We find that IPO firms become actively involved in a spree of acquisitions, funded either by cash, stock, or both, soon after their public listing and remain active over the whole three-year period in the aftermarket. In fact, about a quarter of the IPO companies made at least two acquisitions and one in ten managed at least four such events during the same period; we also observe a broadly similar pattern for raising additional capital through SEOs. In contrast, the IPO firms' divestiture activity is mainly concentrated during the end of the three-year post-listing period. Moreover, the first type of corporate event often sets the pattern of the activities to follow. We also show that only 17% of the IPOs that survived the three-year period were not

involved in any corporate activity after their public listing. The range and intensity of follow-on corporate events across a wide range of recent IPO firms provides strong support for the view that going public is part of a long-term strategy for growth through access to capital markets.

Our evidence suggests that all three types of corporate event are, to a certain extent, motivated by broadly similar considerations that relate to direct and indirect capital needs, recent price performance, market conditions, and the feedback received by key market participants. Cash acquisitions, for example, are likely to come early, funded by additional equity capital proceeds, and involve larger and more profitable firms. Stock acquisitions and SEOs, on the other hand, are linked to less profitable firms, strong market sentiment, significant underpricing at the time of flotation or recent rises in stock prices. Divestitures are also more likely among less profitable but larger firms following recent price declines.

We also provide evidence that the pattern and timing of subsequent corporate activity is related to IPO companies' long-term aftermarket performance. Firms with two or more corporate events during the first 3 years of going public outperform their passive counterparts by the end of the end of the three-year period after flotation. Such differences in performance, however, are not only linked to the type and intensity of post-IPO activity but to the timing and motivation of such corporate events as well.

In other words, our evidence suggests that the long established pattern of aftermarket underperformance is not necessarily an inherent feature of newly listed firms. Like in the case of any other publicly listed firm, their performance is related to their ability to pursue their strategic objectives for long-term growth; the implementation of this process is likely to include a combination of corporate events like acquisitions, SEOs and divestitures. Other recently listed firms, without a sustainable long-term choose to remain wholly inactive or bring to an abrupt end any further plans for corporate activity when their first attempt proves unsuccessful. We believe that this is a fruitful dimension for further research towards understanding the critical linkages between corporate activities and long-term performance of newly listed firms.

4. Reverse Takeovers: Are they a Viable Alternative to IPOs?

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Abstract

We examine the aftermarket performance and survival rates of firms going public through a reverse takeover (RTO) and compare them to the performance of a matched sample of IPOs on the London Stock Exchange (LSE) during the period 1995-2012. We find that RTOs are not fundamentally different from their IPO peers. Given that the UK regulatory framework treats RTOs in the same way as IPOs, our results are consistent with the view that lowering information asymmetry, providing additional protection to investors and thereby reducing mispricing, leads to the elevation of RTOs as a viable alternative to IPOs.

4.1. Introduction

Reverse Takeovers (RTOs), or Reverse Mergers (RMs) as they are usually known in the US, offer an alternative to the traditional IPO route for going public. They refer to a transaction in which a private firm takes control of a public one and becomes listed as a result of the takeover or merger, thereby bypassing the usual IPO process. A large number of firms in the US, Canada, Australia, the UK and others have in recent years chosen the RTO method for their public listing, such as the NYSE, Burger King, Fastjet, West African Minerals and Berkeley Group. The popularity of this method relates to the widely held, but sometimes mistaken, perception that under certain circumstances it is a more effective mechanism than IPOs in terms of lower cost and speed of completion.

Despite the potential benefits in terms of speed and cost, RTOs have attracted considerable adverse publicity and regulatory attention. Bumi in the UK, Sino-Forest in Canada and the large number of Chinese RMs listed in the US between 2001 and 2010,[1] are typical examples of such controversies. This has led to intense debate and scrutiny by investors and regulators as a large number of these cases ended in high profile class actions. The SEC has issued a number of warnings cautioning investors about the potential risks associated with RMs related to the accuracy of RMs' public filings, accounting irregularities and stock price manipulation (MacFadyen, 2011 and Aydogdu *et al.*, 2007).

The US's concerns about RTOs, however, go beyond issues related to foreign listings. They are also linked to the widespread occurrence of significant underperformance of the listed entities in the years following completion and the entities' low survival rates (Gleason *et al.*, 2005 and Adjei *et al.*, 2008).

The purpose of this paper is to assess the potential implications of the regulatory regime on the performance of UK RTOs. As the regulatory frameworks for RTOs and IPOs are broadly similar in the UK, we posit that aftermarket performance, survival rates and the follow-on activities of the two groups should also be very similar. More specifically, we argue that some of the key elements of the UK regulatory framework - such as the precise definition of an RTO in terms of asset class tests together with the requirement of publication of a full prospectus, the required shareholder approval and the potential to raise equity capital at the time of listing - have a number of important implications for the motivation, survival and long-term performance of the listed company.

Firstly, the key characteristics of the UK regulatory framework support transparency and encourage a wider spectrum of companies with different characteristics and motivations to use this route for

going public. Secondly, the requirement of a full prospectus and shareholder approval reduces information asymmetry, provides additional protection to investors and enables the companies involved to describe fully the purpose of their listing and their future plans for growth. Thirdly, the opportunity to raise equity capital at the time of listing and the involvement of underwriters and institutional investors also promotes valuation transparency and shareholder protection.

Given the similarities of the regulatory regimes in UK for the two types of listing, we argue that the choice between an IPO and an RTO depends, in addition to operational characteristics such as the size and profitability of the private entity, on the underlying motivation for going public. For example, the transparency of the regulatory framework and the potential for raising additional equity capital at the time of listing provides an opportunity for a private firm to go public through an RTO and accomplish a genuine synergetic merger at the same time. On this basis, we expect the two types of listing to have broadly similar aftermarket performances, survival rates and levels of follow-on corporate activity to facilitate growth, i.e. raising additional equity capital and involvement in takeovers.

Using a sample of 243 RTOs during the period 1995-2012, matched in terms of size, industry, listing and timing with an equivalent IPO sample, we find strong evidence in support of the contention that the regulatory framework has widespread implications for the motivation and performance of RTOs. Under the broad RTO classification, we find three types of transactions driven by entirely different considerations. They range from takeovers of Mature Shells[1] or Special Purpose Acquisition Companies (SPACs)[1] to Synergy RTOs that involve the merger of a private entity with a going-concern public company in similar types of business that offers viable synergy potential. We also find that while in the US the majority of RMs involve shell companies used by private firms as a route for obtaining a public listing, the majority of UK RTOs involve firms seeking potential synergy gains. In addition, most UK RTOs also raise money at the time of going public and are actively involved after the listing in follow-on corporate activities, such as acquisitions and seasoned equity offerings. Finally, the RTOs' aftermarket performance and their survival rates are broadly similar to their matched IPOs.

Our paper makes three distinct contributions to the RTO literature. First, under the broad definition of an RTO, we find three types transactions: takeovers of mature public shells aiming for a fast public listing, mergers with similar public firms with potential operational synergy gains and takeovers of private firms by SPACs looking for suitable investment targets. Second, we find that survival rates, and the pattern of follow-on corporate activities (seasoned equity offerings and takeovers) are not fundamentally different to their IPO counterparts. Third, the differences in performance across the three types of RTOs suggest that the overall underperformance of RTOs documented in previous studies may be related to the relatively large number of SPACs and Mature shells included in their samples.

Our evidence suggests that the disclosure and transparency of the regulatory framework is enhanced by the lowering of information asymmetry, thereby providing additional protection to investors and reducing the potential for mispricing, leading to the elevation of RTOs as a viable alternative to IPOs. In that sense, our study contributes to the ongoing debate on how best to regulate RTOs and the capital raising activities of small firms in general.

The remainder of the paper is organised as follows: Section 4.2 provides a review of the literature on RTOs (RMs); Section 4.3 describes the data and the methodology used in this study; Section 4.4 shows descriptive statistics of RTOs and IPOs and explores the characteristics of the three distinct types of RTO; Section 4.5 presents an analysis of the choice between RTOs and IPOs; Sections 4.6 and 4.7 show the follow-on activities and aftermarket performance of RTOs and IPOs in our

sample, while Section 4.8 concludes the paper; finally, Appendix describes the regulatory framework for RTOs in the UK and highlights the key differences with the equivalent regime in the US.

4.2. . Related Literature

The literature on RTOs covers a wide range of issues related to the potential implications of the regulatory framework on the choice of method for going public, the motivation and characteristics of firms choosing this route for a public listing, timing, aftermarket performance and survival, and the speed and cost of such transactions.

4.2.1. Regulation

The nature and strictness of securities regulation has always been a policy tool for safeguarding investors' interests by reducing information asymmetry, providing the information required to assess the riskiness of the firm, obtaining fair value for the investment and promoting stock market development (La Porta *et al.*, 2006). Stronger securities regulations are often in response to financial crises, surfacing scandals, corporate governance issues and financial innovations (Hornuf and Schwienbacher, 2014). The optimal level of strictness for small firms, start-ups and, more recently, crowdfunding in need of equity capital, however, remains a matter of ongoing debate. Libertarians argue that a framework free from restrictive procedures and long processes facilitates the funding of small to medium size companies and promotes growth. On the other hand, traditional regulators, in pursuit of safeguarding unsophisticated investors from fraud and speculative activities, remain cautious.

Hornuf and Schwienbacher (2014), for example, show that in the context of crowdfunding, strong investor protection may harm small firms and thus entrepreneurial activities. In the case of RTOs, Carpentier *et al.* (2006) find that their lighter oversight in comparison to IPOs in Canada leads to worse performance, both terms of earnings and stock returns. In short, regulators face the challenge of trying to strike a balance between tailoring securities law to match the financial needs of small firms and, at the same time, protecting investors to a reasonable extent.

The regulatory framework may also have implications for the type of firms choosing the RTO route for going public and their motivation for doing so. The overwhelming majority of the academic evidence, however, focuses on RTOs in general without explicitly considering the potential differences in their characteristics and motivation for going public, and the implications for the future activities and performance of these newly listed firms. Gleason *et al.* (2006), for example, using a relatively small sample of 121 RTOs in the US during the period 1987-2001, find that about 27% of participating public and private firms operate in the same industry, while 31% and 41% come from related and different industry sectors, respectively. Such proximity in industry suggests that expected potential synergies are an important consideration for using the RTO process to go public. Furthermore, while it is widely recognised that RTOs often involve some sort of a shell public company, the fact that such transactions differ both in motivation and the type of the public entity involved is often overlooked.

Carpentier *et al.* (2012) examine the implications of market regulation on RTOs from the perspectives of investors, managers and regulators. The analysis is based on a direct comparison between IPOs and RTOs in Canada, where the latter enjoy relatively easy access to the market and new listings are divided almost equally between the two groups. They find that IPOs in Canada perform better than RMs, both in terms of earnings and stock returns. Their results are consistent with the view that a commitment to a stricter regulatory framework lowers information asymmetry and reduces mispricing. Further evidence on the implications of the regulatory framework is provided by Ignatyeva *et al.*

(2012). They argue that European SPACs are more flexible and able to complete their acquisitions more quickly due to less restrictive regulation by European stock exchanges. Furthermore, the overall average performance of European SPACs is relatively better in comparison to their US counterparts in spite of their negative returns. In fact, smaller European SPACs perform better than the larger ones and even earn a positive return twelve months after the decision date.

The regulatory framework may also have an impact on the cost and speed of completing an RTO and the characteristics and motivation of firms opting for this method of listing. The empirical evidence, however, is not always consistent with this view. In the US, for example, while it is assumed that such transactions can be completed within 60 days at a cost considerably lower than the average of 7% of capital raised for IPOs, the actual costs may depend on the agreed percentage of stocks retained by the original shareholders in the new company (Makamson, 2010). Moreover, as RTO transactions involve shell promoters who charge fees in terms of a certain percentage of ownership interest in the newly created entity, the total cost of the transaction is not necessarily lower if full account is taken of such fees. Along the same lines, the speed advantages are also not always apparent. Although in the US, an RTO can be completed within four months, the actual completion rates vary depending on the complexity of the deal and market conditions.

In one of the very few non-US studies, Brown *et al.* (2013) also provide valuable additional insights into the characteristics and motivation of RTOs, or 'backdoor listings' (BDLs) as they are sometimes referred to, by using a sample from the Australian Stock Exchange (ASX), where the regulatory framework related to such transactions is considerably different to that in the US. Although in Australia there is no formal regulation on RTOs, the ASX may impose readmission requirements as though the company were applying for a new listing. ASX also differs from the US in disclosure requirements by way of prospectus, while concurrent capital raising is found in the majority of cases. Thus, RTOs in Australia are closer substitutes for IPOs than in the US. Nevertheless, the authors find that RTOs in Australia tend be at an earlier stage of development, less profitable, raise less capital and take longer to complete than their matched IPO counterparts.

4.2.2. The RTO vs IPO choice

In order to assess the key determinants in the choice between an RTO and an IPO, Gleason *et al.* (2006) use the proxy statements from managers to shareholders describing these transactions. They report that the most commonly cited reasons for such transactions are the solid financial position of the private firm and the growth prospects of moving into complementary lines of business. They also report that at the time of going public, firms using RTOs tend to be smaller, less profitable and more leveraged than their IPO counterparts in terms of comparable size and industry. Also, in line with self-underwritten IPOs, they exhibit greater likelihood of financial distress and higher leverage in comparison to the matched IPO sample. Floros and Shastri (2009), in a comparison of RTOs with penny stock IPOs, also find that RTOs tend to be smaller and have lower profitability and lower liquidity. More importantly, they also show that private firms often opt for RTOs because they plan to conduct strategic acquisitions using the publicly traded stock as the mode of payment. Arellano-Ostoa and Sandro (2002) also report that, in contrast to the high quality firms that go public through an IPO, reverse takeovers are populated by smaller and largely unknown firms.

Interestingly, a broadly similar pattern is reported by Poulsen and Stegemoller (2008) on the choice between an IPO and a sell-out (the acquisition of a company by a public entity). Their evidence suggests that firms which go public through the latter route tend be lower growth firms with lower valuation ratios at an earlier stage of development. In this sense, sell outs are associated with more information asymmetry, broadly similar to that of their RTO counterparts.

4.2.3. Timing

The choice between an IPO and RTO also depends on timing considerations. In contrast to IPOs, which are more likely to occur under 'hot' market and industry conditions, Brau *et al.* (2003) and Semenenko (2011) show that private firms use distressed public firms as vehicles to go public when market conditions are unfavourable. On the other hand, private firms take control of public firms in good financial health during favourable market conditions. Post-takeover financial performance is very likely to be related to such changing patterns of activity. Furthermore, they also report that most of the private firms which are linked with mergers are small, uncapitalised and have a low probability of survival. On the other hand, private firms merging with companies which qualify as going concerns are similar to those engaging in ordinary merger deals.

Derrien and Kecskes (2007) report similar timing patterns for Introductions on the LSE. They find that, in cold markets, firms substitute Introductions for IPOs and that such offerings occur at the beginning of IPO waves. They also argue that firms use this two-stage strategy to time the market twice: first when listing and again when issuing equity. As exactly the same type of flexibility is also available to RTOs, this is an important additional strategic benefit in relation to IPOs.

4.2.4. Cost Advantage and Aftermarket Performance

Motivated by the recent debate on Chinese Reverse Mergers (CRMs) in the US, Jindra *et al*. (2012) examine the cost and characteristics of CRMs in comparison to Chinese firms which had ordinary cross-IPO listings on US exchanges. During the period 2000-2010, the number of CRMs (100) was almost the same as that of Chinese IPOs (111). They argue that if one of the key motivations for a CRM is lower up-front costs than an IPO, it is reasonable that the companies involved would be smaller and less profitable than those listed through an IPO. Indeed, they find that CRMs are substantially smaller in terms of assets, have higher leverage and a lower analyst and institutional following. Moreover, CRMs have significantly underperformed in comparison to Chinese IPOs. The cost advantage of CRMs almost disappears when account is taken of the litigation costs as a result of the increased probability of class action and the associated costs. Lee *et al.* (2012), however, find that CRMs are generally healthier and perform better than both their US RM counterparts and a group of publicly traded firms matched by industry, size and date. Gleason *et al.* (2006) report that RTOs, in general, outperform their matched traditional IPOs in the short term and tend to exhibit comparable performance in the three years following their public listing. Semenenko (2011) attributes the apparent underperformance of RTOs in comparison to IPOs to their initial overvaluation.

4.2.5. Survival and Follow-on Activities

Adjei *et al.* (2008) shed further light on another dimension of the motivation behind RTOs and their performance by comparing the survival of RTO companies with IPO companies. In contrast to common belief, they report that only 1.4% of the RTO sample do not meet the initial listing requirements for any of the exchange standards. Thus, inability to comply with the standards is not the key motivation for choosing this route for their public listing. Nevertheless, 42.7% of RTOs were delisted by the third year after listing, in contrast to 27% of their IPO counterparts. Such a high rate of failure may be due to information asymmetries as a result of limited disclosure at the time of listing and limited underwriter support. It is also consistent, however, with the view that an RTO is the preferred route for lower quality firms. Furthermore, Jampal *et al.* (2012) argue that in addition to financial performance, the survival of RMs also relates to the terms of governance characteristics of the new firm. They show that survival rates increase for firms with new Seasoned Equity Offerings (SEOs) as well as a concave relationship between average board tenure and the probability of RM survival.

On the other hand, Banerjee *et al.* (2013) find that the survival of RTOs is related to operating performance and not to the method of listing.

Gleason *et al.* (2006) also find that upon announcement, there are significant increases in the price of the public firms. Such gains, however, are not sustainable in the long term and there is little improvement in operational and profitability measures over the subsequent two-year period. Furthermore, more than 50% of the sample does not survive the first two years after the completion of the RTO. It is interesting also to note that they find marked differences in both the industrial composition of their initial sample of RTOs and in the RTO companies' survival. More specifically, their analysis of the surviving entities suggests that 52% are involved in the same industry, 33% operate in complementary areas and about 15% move into different fields altogether. Such differences may be indicative of different motivations in the initial RTO transaction and a possible link between motivation and aftermarket performance. Appadu *et al.* (2013) examine the type and pattern of follow-on activities such as acquisitions, SEOs and divestitures of IPOs during the three-year period after going public. Their evidence suggests that such corporate activities are directly related to the aftermarket performance of IPOs. On this basis, it is reasonable to assume that such activities may also provide another important dimension to the post-listing performance of RTOs.

4.3. Sample and Methodology

The extant literature on RTOs is largely based on US RTO samples from SDC, supplemented by relevant SEC filings (*10-K, 10-Q and 8-K*). The sample size is rather small (a maximum of 314 observations for the period 1996-2008 (Semenenko, 2011)) in comparison to those for IPOs.

Our basic RTO sample comes from LSE statistics for the period 1 January 1995 to 30 June 2012. On the LSE list of new issues and IPO summaries, such transactions are classified by the issue types 'placing and re-admission', 'introduction re-admission', 'offer for subscription re-admission' and 'placing and public offer re-admission'. We compare the primary LSE sample with both the SDC and Zephyr databases and, on the basis of the individual readmission prospectuses,[1] exclude any RTOs, which do not meet the LSE definition of an RTO clearly or do not involve a private company.

The final sample consists of 243 RTOs and 1,643 IPOs for the sample period. Our data collection included a download of the amount of money raised at announcement and pre-announcement financials for the public and private firms from the LSE, SDC and Zephyr. The numbers were verified by a manual process of cross-checking the data with that available in the readmission prospectuses of individual RTOs. For comparative purposes, we also matched a sample of ordinary IPOs during the same time period as the RTO sample. For each of the 243 RTOs in this sample, we found a corresponding new issue from the list of 1,643 IPOs by identifying the date and market of listing (Main vs. AIM), industry classification and asset size, for which we used the assets of the private entity of the RTO, i.e. the firm that was looking to go public.[1] For the purpose of this study, we also collected data for follow-on activities (M&A and SEOs) for three years post the effective date of both the RTOs and IPOs. The M&A and SEO data were downloaded from Bloomberg.

4.3.1. Descriptive statistics of RTOs and IPOs

Table 4.3.1-A shows the annual distribution of the sample of 243 RTOs and 1,643 IPOs, which were listed on the two LSE markets during the period January 1995 to June 2012. The number of completed RTOs accounts for 13% of the total number of listings. It is interesting to note the subtle differences in the annual distribution of issues between the two groups. While, for example, the number of IPOs dropped significantly during the dot.com bubble in 2000-01, the flow of RTOs was not affected; however, the number of RTO transactions increased in line with IPOs during the 2004-

06 recovery of IPO activity. Furthermore, during the recent crisis, when the number of IPOs dropped by 97% during 2007-09, the decline of RTOs was relatively modest. More specifically, for the first time ever, in 2009 the number of listed RTOs (eight) was twice the number of their IPO (four) counterparts. Thus, there is some evidence to suggest that for companies, which meet the regulatory requirements necessary to carry out an IPO but do not need to raise money at the same time, going public reduces information asymmetry and makes it relatively easier for them to get a public listing during adverse market conditions. Floros and Sapp (2011) show that in the US, the number of RMs in each of the years during the 2001-08 period was greater than the number of traditional IPOs. They argue that this increase relates not only to the introduction of Sarbanes-Oxley in July 2002 but also to the obligation on shell companies to make regular filings, making them more transparent to private acquirers and helping them

Table 4.3.1-A: Annual distribution of IPO and RTO activity during the period 1995-2012

The table shows the annual distribution of IPO and RTO transactions. The data on IPOs is from the London Stock Exchange (LSE) statistics website while the RTO data is sourced from the LSE, Bureau van Dijk and SDC Platinum, and has been subsequently cross-referenced with the company prospectuses produced for the purpose of the listing. Panel A compares the annual distribution of IPO and RTO activity, including the total money raised ($m) from both types of public listing. Panel B compares the annual frequency per the three types of RTO in our sample: Mature Shells, SPACs and Synergy RTOs.

	RTOs					IPOs	
	Observations (Number)	**Without money raised (Number)**	**With money raised (Number)**	**With money raised (%)**	**Money raised (£m)**	**Observations (Number)**	**Money raised (£m)**
1995	4	4	0	0	0	11	53
1996	2	2	0	0	0	82	419
1997	7	4	3	43	25	53	273
1998	11	5	6	55	46	71	7,119
1999	9	4	5	56	20	77	10,951
2000	13	5	8	62	58	201	9,276
2001	13	2	11	85	290	78	4,892
2002	17	8	9	53	45	54	3,983
2003	8	5	3	38	21	50	2,586
2004	23	4	19	83	246	214	4,375
2005	43	18	25	58	309	261	8,471
2006	41	14	27	66	182	200	13,534
2007	14	4	10	71	92	144	11,096
2008	13	4	9	69	61	30	3,227
2009	8	4	4	50	85	4	414
2010	10	3	7	70	23	49	8,879
2011	5	2	3	60	13	46	5,780
2012	2	2	0	0	0	18	374
ALL	**243**	**94**	**149**	**61**	**1,515**	**1,643**	**95,700**

to improve their negative image somewhat. In fact the increasing number of RTOs in the US and UK, although for different reasons, may account, to a certain extent for the drop of IPOs raised by Gao, Ritter and Zhu (2013) and Ritter, Signori and Vismara (2013).

The table also shows that, in sharp contrast to the US where RMs usually do not raise money at the time of the listing (Gleason *et al.*, 2005 and 2006), 61% of the total sample of UK RTOs raised money at the time of going public. The average amount raised by RTOs is relatively small – £10.1m – in comparison to the £58.2m raised by the average IPO during the same time period. These large differences are, however, mainly driven by a small number of very large IPOs; the median amount raised by IPOs is just £7.2m in comparison to £3.5m for the equivalent RTO. It is also worth noting that the overwhelming majority (85%) of RTOs were listed on AIM, while the equivalent proportion of ordinary IPOs during the same period was below 70%.

4.3.2. Types of RTOs

A preliminary review, of the public entities which are involved in RTOs, indicates significant differences in the type of private and public firms participating in such transactions. Following a detailed assessment of the background, financials and motivation for the acquisition from the individual re-admission prospectuses, we identified three distinct types of RTOs: Mature Shells, SPACs and Synergy RTOs.

Our first type of RTO is the 'Mature Shell' type. This is a publicly listed entity, which has been listed for more than a year by the time of the RTO but is not operating. It is most likely to be a business, which ran into financial difficulties but remained listed as a cash shell. It could also be a firm selling its operations and assets following bankruptcy. This group of RTOs is similar to a large number of the shells involved in US RMs.

Our second type of RTOs involves the takeover of a Special Purpose Acquisition Company (SPAC), a newly listed firm with the sole intent of merging with unidentified single or multiple private or public firms within the first 12-18 months of going public.[1] At the time of the RTO, the public entity may have cash assets only and no sources of revenue and is, in that sense, another type of shell, sometimes described as a naked shell.

The third type is the 'Synergy RTO', which is a publicly listed entity that is fully operational and which has been listed for more than a year before an RTO is announced. We call this a Synergy RTO as it involves a genuine takeover of a (public) firm, which is in the same type of business as the private acquirer with the intention of building a new, larger public company that will benefit from the synergies between the two parties. This type of RTO is clearly different from Mature Shells, where the targeted shell is only intended as a vehicle for capital growth, rather than any synergy acquisition objectives.

Table 4.3.2-A shows a breakdown of our RTO sample according to the three distinct types of RTOs. In stark contrast to the previous literature in this field, which focuses mainly on the US where RTOs tend to involve a public shell company, Synergy RTOs emerge as the most common type in UK with more than 50% of the sample falling into this category, followed by SPACs (31%) and Mature Shells (17%). Furthermore, the annual breakdown shows a relatively low level of activity in the boom period (2004-07) for Mature Shell RTOs but a significantly higher level of SPAC and Synergy RTO activity during this period. This relatively higher level of SPAC activity suggests that such listings may be taking advantage of favourable market conditions rather than pure business considerations. The annual number of Mature Shells, on the other hand, is relatively stable over the same sample period; this reflects the nature of such transactions as they are more a corporate 'rescue' type of activity and

Table 4.3.2-A: Annual distribution of RTO activity: Mature Shells, SPACs and Synergy RTOs during the period 1995-2012

	Mature Shells		SPACs		Synergy RTOs	
Year	No. Observations	%	No. Observations	%	No. Observations	%
1995	0	0	0	0	4	100
1996	0	0	0	0	2	100
1997	1	14	1	14	5	71
1998	3	27	0	0	8	73
1999	2	22	3	33	4	44
2000	4	31	3	23	6	46
2001	2	15	3	23	8	62
2002	3	18	5	29	9	53
2003	1	13	2	25	5	63
2004	5	22	5	22	13	57
2005	7	16	17	40	19	44
2006	3	7	20	49	18	44
2007	2	14	6	43	6	43
2008	3	23	3	23	7	54
2009	3	38	3	38	2	25
2010	1	10	3	30	6	60
2011	1	20	1	20	3	60
2012	1	50	1	50	0	0
ALL	**42**	**17**	**76**	**31**	**125**	**52**

happen as the opportunity arises to 'save' a struggling entity by combining it with another which needs cash. Interestingly, the highest relative activity of this type was in 2012.

In an unreported table, we find further evidence of the differences between IPOs and RTOs as a whole and their three distinct groups, showing details of their money raising activity at the time of going public. In contrast to the US, raising money is an important component of such transactions: 61% of all RTOs in the UK raise equity at the time of going public.[1] The amount raised by the median RTO is £3.46m, which is about half that raised by the equivalent IPO (£6.51m) but broadly consistent with their respective total assets and market values. On the other hand, the average amount raised

by RTOs as a proportion of market value (41.5%) is higher than the equivalent 30.6% for IPOs. This is predominantly due to Synergy RTOs, which raise an amount equal to 57.8% of the market value, clearly indicating that those companies that go public with a public entity in the same type of business do raise money (57.8%) with the clear intention of future expansion. On the other hand, mature RTOs raise a relatively small amount of money (a median of £1.58m), both in absolute terms and in relation to their market value (15.8%). Not surprisingly, SPACs raise relatively modest amounts of money at the time of transaction, probably relying on the significant cash reserves of their public partners for future growth. In fact the amount raised by RTOs (23.2%) is almost the same as IPOs (24.16%) only Mature Shells raised less than IPOs.

4.4. The Choice between RTO and IPO

Given the unique nature of each of the three identified groups of RTOs we expect some distinct differences in the operational characteristics both among the three RTO groups, and between the RTOs as a whole and their matched sample of IPOs. More specifically we observe the following key differences:

- RTOs in general are smaller, less profitable and more leveraged than their equivalent IPO counterparts. This is in line with the US evidence (Floros and Sapp, 2011) and simply reflects the earlier stage of development of RTOs in comparison to IPOs. A possible exception to this well pattern, are the private entities of synergy RTOs that are usually well established firms seeking growth through a merger with a public entity of similar nature

- The publicly listed entity in an RTO is also generally smaller than an IPO, in terms of assets and revenue, and unprofitable but with high levels of cash on the balance sheet in comparison to its private counterpart

- Given the nature of the public entities of mature shells they are likely to be smaller and less profitable in comparison to the other types of RTOs

- As RTOs do not have to raise funds at the time of listing they are more likely to proceed with a public listing even in unfavourable market conditions

- Because the key purpose of a SPAC is to complete an acquisition within a defined period since the listing, it is reasonable to expect that they maintain high levels of cash

Finally it is worth noting that in sharp contrast to the US, where listing fees for RMs are lower than for IPOs, the UK practise is rather different. The requirements of the UK regulatory framework have a direct impact on the fees involved to complete the listing. Such additional costs relate to the raising of equity at the time of the RTO and associated underwriting costs, the preparation and issuance of a full prospectus and readmission fees to the stock exchange.

Although precise data of such costs is not available, our investigation based on the information included in the readmission prospectuses[1] and other relevant market sources suggests that the average fees for RTOs, both in AIM and Main markets are not significantly different from their IPO counterparts.

4.4.1. Descriptive statistics

Table 4.4.1-A, panel A reports descriptive statistics for the medians of total assets, revenue, profitability, cash holdings, total debt and a number of related performance indicators for the whole sample of public and private RTO firms, for each of the three groups separately and for the matching sample of IPOs.

In line with our expectations, the typical private RTO entity in the UK is indeed generally smaller, with lower turnover and higher levels of debt and cash in comparison to their IPO counterparts. Furthermore, the publicly listed entity in an RTO is smaller in size in terms of assets and revenue, and unprofitable but with high levels of cash on the balance sheet in comparison to its private counterpart. This is particularly true for Mature Shell public entities. On the other hand, the public and private entities of Synergy RTOs are more similar to IPOs than the SPAC and Mature Shell pairs. Our evidence is broadly consistent with the US evidence which shows that larger firms are in general more likely to go public through an IPO rather than staying private (Chemmanur *et al.*, 2010) or selling out to a public company (Brau *et al.*, 2003).

The assets for the median private firms in the Synergy RTOs group are £5.64m in comparison to £2.65m and £1.26m for the equivalent Mature Shell and SPAC RTO group firms, respectively. Synergy RTOs also involve larger public companies in terms of sales operating at a profit in the last year before takeover, in contrast to their Mature Shell and SPAC counterparts. It is also interesting to note that in terms of assets, sales and profitability, the profiles of private firms involved in Synergy RTOs are broadly similar to our matched IPO sample during the same period, suggesting that, while for such companies a direct IPO could have been a feasible alternative, they opted for an RTO instead on the basis of the speed and potential cost advantages of going public and completing an acquisition at the same time. In this respect, our results in relation to the Synergy RTOs are consistent with Adjei (2008), who finds that only 1.4% of US RTOs do not meet the listing requirements.

Table 4.4.1-B provides further evidence of the differences between IPOs and RTOs as a whole and their three distinct groups, showing details of their money raising activity at the time of going public. In contrast to the US, raising money is an important component of such transactions: 61% of all RTOs in the UK raise equity at the time of going public.[1] The amount raised by the median RTO is £3.46m, which is about half that raised by the equivalent IPO (£6.51m) but broadly consistent with their respective total assets and market values. On the other hand, the average amount raised by RTOs as a proportion of market value (41.5%) is higher than the equivalent 30.6% for IPOs. This is predominantly due to Synergy RTOs, which raise an amount equal to 57.8% of the market value, clearly indicating that those companies that go public with a public entity in the same type of business do raise money (57.8%) with the clear intention of future expansion. On the other hand, mature RTOs raise a relatively small amount of money (a median of £1.58m), both in absolute terms and in relation to their market value (15.8%). Not surprisingly, SPACs raise relatively modest amounts of money at the time of transaction, probably relying on the significant cash reserves of their public partners for future growth. Moreover, the amount raised by RTOs (23.2%) is almost the same as IPOs (24.16%). In fact only Mature Shells raised less than IPOs.

Table 4.4.1-A: Descriptive statistics for public and private RTO entities at the time of public listing

This table shows key financial characteristics for the public and private entities in the whole sample of RTOs and matched IPOs. The RTO entities have been matched – in terms of the approximate date of listing, industry classification and assets size (using the private entity's assets) – with an IPO counterpart. The table also shows each of the three groups separately. The median values of *Total Assets*, *Sales*, *EBITDA* and *Cash* for each of the groups are in £m. The data is from the accounts of the individual entities at the time of listing or the last published accounts prior to the public listing as reported in the prospectuses of individual transactions. Panel A shows descriptive statistics for all of the RTOs in our sample and Panel B reports descriptive statistics related to the actual amount raised at the time of the public listing. The RTO statistics only relate to the issues which actually raised money at this point in time. Table 2 also shows the median test between RTO and the three components (Mature Shells, SPACs and Synergy RTOs) and the Matched IPO sample where *, ** and *** indicate significance at 10%, 5% and 1%, respectively.

		All RTOs		Mature Shells		SPACs		Synergy RTOs		
		Pri-vate	Pub-lic	Private	Pub-lic	Private	Pub-lic	Private	Pub-lic	Match-ing IPOs Sample
Total assets (£m)	Median	3.47	2.75	2.65	1.36	1.26	1.48	5.64	4.66	4.15
	No. Observa-tions	242	239	41	42	76	73	125	124	242
Sales (£m)	Median	2.75	0.16	2.08	0.00	0.49	0	5.59	2.03	3.23
	No. Observa-tions	240	240	41	42	75	74	124	124	233
Sales/total as-sets (%)	Median	92.04	6.08	107.78	1.34	57.59	0	92.48	44.83	75.80
	No. Observa-tions	239	237	41	42	74	73	124	122	228
EBITDA (£m)	Median	0.03	-0.13	0.09	-0.19	-0.01	-0.08	0.25	-0.19	-0.07
	No. Observa-tions	239	240	41	42	75	74	123	124	230
EBITDA/total assets (%)	Median	1.80	-6.71	4.81	-22.16	-0.12	-5.69	4.20	-4.72	-4.12
	No. Observa-tions	238	237	41	42	74	73	123	122	224
Cash (£m)	Median	0.19	1.81	0.36	1.03	0.08	1.38	0.22	2.23	0.69
	No. Observa-tions	237	239	41	42	74	73	122	124	232
Cash/total as-sets (%)	Median	7.94	88.80	16.31	100	8.33	100	5.83	69.84	16.59
	No. Observa-tions	236	238	41	42	74	72	121	124	222
Debt	Median	1.77	0.34	0.70	0.34	0.42	0.06	2.76	0.85	0.61
	No. Observa-tions	188	217	31	35	57	69	100	113	237
Debt/total as-sets (%)	Median	75.73	21.13	65.92	25.94	73.76	4.81	79.47	29.09	19.71
	No. Observa-tions	187	215	31	35	56	68	100	112	233

Table 4.4.1-B: Number of RTOs and matched IPOs raising money and amounts raised at the time of listing

	All RTOs	Mature Shells	SPACs	Synergy RTOs	Matched IPOs

Number of issuers raising money		149	28	50	72	243
% of issuers raising money	Mean	61.2	66.7	66.7	56.7	100
Amount raised (£m)	Mean	10.12	4.69	9.77	12.47	21.15.81
	Median	3.46	1.58	2.75	4.40	6.51
Market value (£m)	Mean	45.30	22.84	23.48	63.52	96.65
	Median	14.72	13.06	15.73	16.07	23.5828
Amount raised/market value (%)	Mean	41.5	20.1	25.1	57.8	30.62
	Median	23.2	15.8	24.3	25.9	24.16

4.5. Logit analysis: RTO vs IPOs

To assess the likelihood of a private firm going public through an RTO instead of the traditional IPO route and how the types of RTO differ from each other in a multivariate framework, we use a logit regression model based on company characteristics and market conditions.

Equation 1 presents the logit regression where the dependent variable is set to 1 when there is an RTO and 0 for a firm in the IPO matching sample.

$$A_{it} = a_i + \beta_1(SIZE) + \beta_2(LIQ) + \beta_3(LEV) + \beta_4(PROF) + \beta_5(ATO) + \beta_6(-3RET) + B_7(CONS) + B_8(TECH) \quad (1)$$

On the basis of previous RTO literature and the nature of such transactions, we expect that firms using this route to go public are smaller, at an earlier stage of development with lower profitability and possibly limited balance sheet liquidity. There is also evidence to suggest that they cluster in certain industries and, under such circumstances, are more likely to find it harder to attract the widespread institutional interest necessary to enable them to complete a successful IPO. This is particularly the case during periods of favourable market conditions when a number of more attractive firms are preparing for an IPO. We proxy the size of the private firm with the logarithm of Total Assets (Assets), Balance Sheet Liquidity by the ratio of cash and cash equivalents to total assets (Cash/Assets), Leverage with the ratio of total debt to total assets, Profitability with the ratio of EBITDA to total assets and Efficiency with sales to total assets.[1] We use the FTSE All-Share Index during the three months before the RTO/IPO as an indicator of market conditions and two dummy variables which take the value of 1 for both Consumer Services and Technology firms and 0 otherwise[1].

We use a similar binomial logit model to assess the choice between each of the three types of RTO (Mature, SPAC and Synergy) against the other two based on the characteristics of both the private and public entities in an RTO transaction. In this case, the dependent variable is set to 1 for one of the three RTO groups and 0 for the other two. Thus, we run three separate regressions for each group as the dependent variable using the characteristics of both the public and private entities involved in the RTO transaction. We expect the public entities of Mature Shells and SPACs to hold proportionally higher levels of cash on their balance sheets, have lower asset turnover and be smaller in size than their Synergy counterparts.

Table 4.5-A, Column 1 shows the results of the logit for the choice between an IPO and an RTO. The dependent variable is set to 0 for IPOs and 1 for RTOs. Consistent with the univariate descriptive statistics, the negative and significant coefficients for the assets and cash/assets of the private entities confirm that private entities in RTOs are in general smaller and hold a lower proportion of cash to total assets in comparison to their IPO counterparts. Although this is entirely consistent with the US evidence, it is important to note that in unreported results of the same binomial model of IPOs vs the private entities of each of the three RTO groups separately, we find that such differences are in fact entirely due to SPACs and Mature RTOs. Synergy RTOs are similar in size and more profitable than their IPO counterparts. The negative and significant coefficient for the three-month market return is also consistent with the notion that RTOs time their listings during difficult market conditions.

To access the potential differences among the public companies involved in each of the three identified types of RTOs, Columns 2-4 report results for the differences between the three RTO groups on the basis of the characteristics of public and private entities separately. In Model 2 (private and public), the dependent variable is set to 1 when there is a Mature RTO and 0 otherwise, in Model 3 (private and public) the dependent is 1 for a SPAC and 0 otherwise, while in Model 4 (private and public) the dependent is 1 for Synergy and 0 otherwise. The results highlight some of the significant differences between the three groups of RTOs. First, Column 2 (public) shows that the public entities of the Mature Shells are smaller and less profitable in comparison to their SPAC and Synergy counterparts. Second, the negative and significant coefficient for asset turnover and the positive coefficient for cash liquidity in Column 3 (public) confirm that the SPACs' public entities maintain high levels of cash as they are searching for suitable takeover targets. Third, the positive and significant coefficients for the assets in Column 4 (private and public) suggest that both the private and public entities of Synergy RTOs are larger than their Mature and SPAC counterparts; at the same time, the public entities of Synergy RTOs carry a higher level of debt in comparison to the other two groups while their private counterparts are more profitable in spite of their lower asset turnover. Fourth, the apparent tendency of RTOs in general to time their listing during unfavourable conditions is driven entirely by Mature Shells. There is no evidence to suggest timing considerations for SPACs or Synergy RTOs. It is also interesting to note that the overall popularity of the Consumer Services sector among RTOs is predominantly due to Mature Shells, while it is less prevalent among SPAC and Synergy RTOs. Overall, our evidence suggests that the choice of RTO type is predominantly driven by the characteristics of the public rather than private entities involved in such transactions.

Table 4.5-A: The choice between RTO and matched IPO and between the three different types of RTO

The table reports the results from a logit regression for the choice between IPO and RTO and the choice of RTO type, based on a set of private (prv) and public (pbl) entity characteristics and market conditions. Two industry dummies are included, *Consumer Services* and *Technology*, as they represent a significant proportion of our sample: 24% and 13% respectively. The dependent variable in Column 1 is set to 1 for RTOs and 0 for IPOs. In Columns 2-4 the dependent variable is set to 1 for the specific RTO group and 0 for the other two. *, ** and *** indicate significance at 10%, 5% and 1%, respectively.

	Matched IPO vs RTO (1)	**Mature Shells (2)**		**SPACs (3)**		**Synergy (4)**	
	Private entities	Private entities	Public entities	Private entities	Public entities	Private entities	Public entities
Assets	-0.101* (-1.70)	-0.082 (-0.73)	- 0.306*** (-2.93)	0.274*** (-2.79)	-0.177** (-1.94)	0.262*** (3.05)	0.371*** (3.58)

Cash/assets	-0.995** (-2.25)	1.346* (1.65)	-0.033 (-0.22)	-0.706 (-0.90)	1.135** (2.34)	-0.245 (0.35)	-0.245 (1.02)
EBITDA/assets	-0.012 (-0.66)	0.019 (1.11)	-0.062* (1.58)	-0.342* (-1.79)	0.401** (2.51)	0.474** (2.31)	-0.015 (0.70)
Debt/assets	0.771*** (3.88)	-0.089 (-0.34)	-0.229 (-0.82)	-0.047 (-0.19)	- (-2.65) (-0.01)	0.089 (0.47)	0.01** (2.55)
Asset turnover	-0.048 (-1.13)	0.092 (0.76)	0.112* (1.78)	0.135 (1.35)	-0.945* (-1.35)	-0.199* (0.47)	0.088 (1.10)
-3m market return	-4.759** (-2.43)	-6.671** (-1.94)	-3.535 (-1.11)	6.015** (2.23)	1.094 (0.50)	-0.791 (0.32)	0.992 (0.41)
Technology	-0.489 (-1.49)	1.089* (1.84)	1.025* (1.87)	-0.838 (-1.61)	-0.829 -(1.59)	0.190 (0.39)	0.168 (0.37)
Consumer Services	-0.075 (-0.29)	1.559*** (3.26)	1.337* (2.61)	-1.407** (2.72)	-1.083** (-1.59)	0.045 (.12)	0.168 (0.47)
Intercept	0.718* (1.69)	-1.911*** (1.65)	0.045 (0.05)	1.491 (1.60)	0.587 (0.72)	-1.700** (-2.08)	-2.792*** (-3.20)
No. Observations	386	211	211	211	211	211	211

To test the robustness of the binomial model for differences among the three RTO groups, we also applied a multinomial logit model where the dependent variable is set to 1 for Synergy, 2 for Mature and 3 for SPAC RTOs. We use the same variables as in the binomial model for both the private and public entities in an RTO. The results obtained, but not tabulated, are broadly similar with the conclusions drawn from the binomial model.

4.6. Post-Listing Survival and Follow-on Corporate Activities

The marked differences in the operational characteristics between RTOs and IPOs and the three types of RTO are likely to have direct implications on their survival, follow-on activities and aftermarket performance after public listing. It can be argued, for example, that the smaller size and lower profitability of RTOs are indicators of poor quality, which effectively rules out a conventional IPO listing and, consequently, results in lower survival rates.

Table 4.6-A reports the survival rate of RTOs during the first 6, 12, 24 and 36 months of going public as a the result of a takeover, bankruptcy or voluntary delisting. These are reported for RTOs as a whole and for each of the three groups separately, and for comparative purposes we also show the equivalent delisting rates for our matched sample of IPOs. The results show that while the survival rate of RTO firms is very similar to that of IPO firms within the first year of going public, both for the group as a whole and for the three separate types, the pattern changes gradually over time. By the end of the 36-month period, the survival rate of RTOs is 80% in comparison to 90% rate for IPOs.

It is also worth noting that although the UK RTO survival rate is lower than that of IPOs, it is nevertheless markedly higher than the US rate. Gleason *et al.* (2005), for example, report that only 46% of the companies in their RM sample survived longer than two years in comparison to a robust 93% for IPOs. Broadly similar results are reported by Adjei *et al.* (2008) and Jambal *et al.* (2012). This suggests that the tighter UK regulatory frame

Table 4.6-A: Survival rates for IPO and RTOs

work, in terms of shareholder approval and raising money, enhances transparency and improves the quality of such transactions. Interestingly, in Panel B, in which the takeover reason for delisting is

This table reports the results of a survival analysis of IPOs and RTOs as whole and by RTO type. For each time period (6, 12, 24 and 36 months after listing), we show the percentage of firms which survived. Note that the full sample size will decrease as the length of time increases (n=243 will decrease with time t) as some of the firms in our sample were listed during the last three years, hence their survival rate is still to be determined. Panel B shows the same analysis as Panel A, but excludes firms which delisted because they were targets in a takeover.

		All	All	Mature Shells	SPACs	Synergy RTOs
		Matched IPO	RTO	RTO	RTO	RTO
Panel A: Percentage of firms surviving voluntary delisting, bankruptcy or takeover during the period						
6-month survival rate	%	100	98	100	99	98
	No. Observations	242	239	42	75	122
12-month survival rate	%	98	98	98	99	97
	No. Observations	238	235	40	74	121
24-month survival rate	%	95	90	90	85	93
	No. Observations	227	213	37	63	113
36-month survival rate	%	90	80	77	75	85
	No. Observations	203	182	30	53	99
Panel B: Percentage of firms surviving voluntary delisting or bankruptcy, excluding takeovers, during the period						
6-month survival rate	%	100	99	100	100	98
	No. Observations	242	240	42	76	122
12-month survival rate	%	98	98	98	100	97
	No. Observations	238	236	40	75	121
24-month survival rate	%	96	93	95	89	95
	No. Observations	228	221	39	66	116
36-month survival rate	%	91	87	87	86	88
	No. Observations	206	198	34	61	103

removed, the difference in survival rates between IPOs and RTOs is reduced to just 4%.

There also are some differences in the survival rates over the three-year period following an RTO between the three groups. While, for example, only 75% of SPACs survive the three years, the equivalent proportions for Synergy RTOs and Mature Shells are 85% and 77%, respectively. Such differences, however, appear to be predominantly due to delistings related to takeovers. Excluding them, the results in Panel B suggest broadly similar survival rates for all three types of RTO.

Table 4.6-B explores another important dimension to the potential differences in the underlying motivation for going between IPOs and RTOs, by tracking their follow-on corporate activities, in terms of acquisitions and raising additional equity capital, during the three-year period following their public

listing. The table shows the number and percentage of corporate events as a proportion of the total number IPOs and RTOs in the sample 6, 12, 24 and 36 months after going public.

This table shows the analysis of follow-on activity of IPO- and RTO-matched firms, per RTO type. In Panel A, for each time period (6 months and 1, 2 and 3 years after listing), we show the number of follow-on events (acquisitions or SEOs) as a proportion of the number of firms. Note that the full sample of firms will decrease as the length of time increases as some of the firms in our sample were listed during the three years before the data collection cut-off date. Panel B shows the same analysis as Panel A but takes instead the number of firms with at least one corporate event, i.e. those which were active during the given time period, as a proportion of the number of firms.

		Matched IPOs	RTOs			
		ALL	**ALL**	**Mature Shells**	**SPACs**	**Synergy RTOs**
6-month acquisition rate	%	32	10	7	18	6
	No. Events	78	25	3	14	8
1st year acquisition rate	%	50	31	24	41	27
	No. Events	122	75	10	31	34
2nd year acquisition rate	%	86	73	98	66	70
	No. Events	210	174	40	49	85
3rd year acquisition rate	%	107	111	149	99	106
	No. Events	261	252	58	70	124
6-month SEO rate	%	12	10	5	11	11
	No. Events	29	24	2	8	14
1st year SEO rate	%	23	24	17	21	28
	No. Events	56	58	7	16	35
2nd year SEO rate	%	47	53	49	58	52
	No. Events	113	126	20	43	63
3rd year SEO rate	%	64	70	72	76	67
	No. Events	155	160	28	54	78
6-month event rate	%	44	20	12	29	18
	No. Events	107	49	5	22	22
1st year event rate	%	73	55	41	63	55
	No Events	178	133	17	47	69
2nd year event rate	%	133	127	146	124	121
	No. Events	323	300	60	92	148
3rd year event rate	%	171	181	221	175	173
	No. Events	416	412	86	124	202

Values higher than 100% indicate that some of the IPOs/RTOs are involved in several follow-on activities. During the first six months of listing, the 243 IPOs in the sample were involved in 77 acquisitions; on the other hand, the 243 RTOs were involved in only 25 acquisitions. RTOs, however, become more active in acquisitions at a later stage of their public life; in fact, by the end of the third year of listing, the remaining 228 RTOs were involved in 252 acquisitions in contrast to only 223 by IPOs. This is mainly driven by a substantial number of acquisitions made by Mature and Synergy RTOs. A broadly similar pattern of increasing corporate activity across all three groups of RTOs is observed for SEO activity as well.

Table 4.6-B: Follow-on activity

In spite of the apparent similarities in the overall volume of corporate activity between IPOs and RTOs during the three-year period following public listing, it could still be argued that the drivers of such activities differ between the two groups. While for an IPO, for example, raising additional equity capital may be considered the customary path for future growth, the inherent diversity of RTOs may necessitate a more direct approach, depending on performance and underlying fundamentals. RTOs, for example, planning for future growth through acquisitions, may raise additional equity at the time of their RTO while the actual execution of their strategy may depend on subsequent performance.

In Table 4.6-C, we assess the potential differences in follow-on activities in terms of acquisitions and SEOs between IPOs and RTOs during the three years after flotation controlling for the market of listing (Main or AIM), whether the IPO/RTO raised capital at the time of listing, the abnormal performance (total return) at the end of the 36-month period after flotation and industry dummies for Consumer Services and Technology. Column 1 shows the regression results for all of the follow-on activities while Column 2 shows the results for acquisitions and SEOs separately.

As the IPO/RTO variable in Column 1 takes the value 0 for IPOs and 1 for RTOs, the positive coefficient suggests that RTOs are in fact marginally more active in terms of acquisitions and SEOs in comparison to their IPO counterparts, and are spread across both markets**.** Looking separately at acquisitions and SEOs, the significant coefficients for IPOs/RTOs clearly suggest that RTOs are equally active as IPOs in each of these two types of corporate activities. Acquisitions are more likely to take place in the Main market, while SEOs are more popular in AIM. Not surprisingly, raising equity capital is a reliable predictor of further corporate activity for both RTOs and IPOs, and the rather strong aftermarket performance is also heavily related to corporate activity in terms of both acquisitions and SEOs.

From the above results, the weight of evidence in terms of survival rates and the volume of follow-on corporate activity and its pattern suggests that UK RTOs, in sharp contrast to their US counterparts, are not fundamentally different in these respects from IPOs.

Table 4.6-C: Follow-on corporate activity

The dependent variable in Column 1 is the total number of acquisitions and SEOs during the three-year period after public listing, while the dependent variables in Columns 2 and 3 cover each of the two types of activity separately. The *IPO/RTO* variable takes the value of 1 for RTOs and 0 for Matched IPOs. The dummy for *Main/AIM* is equal to 1 for issues listed on the Main market and 0 for AIM. *Raise capital* takes the value of 1 for issues which raised capital at the time of listing and 0 otherwise. *BHAR36* is the buy-and-hold abnormal return for an issue relative to the FTSE All-Share Index or the FTSE SmallCap Index as the market benchmark. Two industry dummies have been included as they represent a significant proportion of the sample: *Consumer Services* is the most common industry classification, accounting for 24% of the total population of RTOs and *Technology* accounts for 13%. *, ** and *** indicate significance at 10%, 5% and 1%, respectively.

	All (1)	**Acquisitions (2)**	**SEOs (3)**
IPO/RTO	0.360*	0.173	0.187*
	(1.54)	(0.88)	(1.69)
Main/AIM	0.801**	0.874***	-0.072
	(2.44)	(3.16)	(-0.47)

Raise capital	0.796***	0.518**	0.278**
	(2.68)	(2.06)	(1.99)
BHAR36	0.678***	0.504***	0.173***
	(4.84)	(4.27)	(2.63)
Technology	-0.309***	0.048*	-0.356**
	(-1.01)	(0.18)	(-2.49)
Consumer Services	0.537**	0.599***	-0.061
	(2.20)	(2.90)	(-0.53)
Constant	0.856***	0.390	0.466***
	(2.50)	(1.35)	(2.89)
Adjusted R^2	0.078	0.075	0.024
No. Observations	469	469	469

4.7. Aftermarket Performance

Long-term aftermarket performance estimates are based on BHARs for each RTO. These are computed as:

$$BHAR = \frac{1}{N}\sum_{i=1}^{N}\left[\left(\prod_{t=1}^{T}(1+r_{it})\right)-\left(\prod_{t=1}^{T}(1+r_{bt})\right)\right] \qquad (2)$$

where r_{it} and r_{bt} are the raw returns on RTO i and the selected benchmark b at event month t.

The sample covers the period from January 1995 to June 2009 and the BHARs are calculated for each new issue until the earlier of either their third anniversary or delisting date. We report results for the first 6, 12, 24 and 36 months, excluding first-day returns, using two alternative benchmarks: the FTSE All-Share Index for issues listed on the Main market and the FTSE Small- Cap Index for those on AIM. The null hypothesis that the mean BHARs are equal to zero is tested using the skewness-adjusted t-statistic with bootstrapped p-values, as suggested by Lyon, Barber and Tsai (1999) and adapted by Jelic, Saadouni and Wright (2005). Note, the number of issues included in the calculation of BHARs declines with the month of seasoning.

Table 4.7-A reports four panels. Table 4.7-A (Panel A) reports 36-month equal and value-weighted BHARs for the samples of RTOs and IPOs in both the Main and AIM markets while panel B and C shows separate results for all IPOs and RTOs listed in each of the two markets respectively.

Finally Panel D shows the equivalent returns for each of the three RTO groups, i.e. SPACs, Mature Shells and Synergy RTOs, separately.

Consistent with the RM evidence for the US (Carpentier, 2012 and Semenenko, 2011), our equivalent UK RTO sample as a whole also underperforms the relevant benchmarks during the three-year period, at least in value-weighted terms. We find negative and statistically significant value-weighted BHARs throughout the 36-month period after the public listing of the RTO, starting from -7.80% in

month 6, gradually declining to -30.64% by month 36. The equivalent 36-month value-weighted BHAR for IPOs is -4.99% but not statistically significant. It is interesting to note the striking difference in the pattern of market value-weighted BHARs between IPOs and RTOs. Consistent with previous studies, (Levis, 2011) the 36-month value-weighted BHARs for our sample of IPOs are generally higher than their equally-weighted BHAR counterparts *(-4.99 vs. -34.34%***)* suggesting that larger IPOs perform relatively better on average than their smaller counterparts. Table 4.7 (panel B) provides further support for the differences in performance by size by showing separate results for the IPO in each of the two markets, i.e. Main and AIM. IPOs in the main market perform consistently better than their AIM counterparts. While the 36-month returns of AIM IPOs are consistently negative for both the equally weighted average and the value weighted average, their Main counterparts are positive and statistically significant for the value weighted only

Table 4.7-A: Aftermarket Performance: Buy-and-hold abnormal returns

This table reports 36 months Buy-and - hold (BHAR) returns for our sample of RTOs and matched IPOs. The BHAR are adjusted to the FTSE All-Share Index (Main IPO or RTO) or the FTSE SmallCap Index (AIM IPO or RTO). *EW* is the equally-weighted portfolio and *VW* is the value-weighted portfolio. *Observations* is the number of companies in the portfolio at each time period (months 6, 12, 24 and 36 after listing). *, ** and *** indicate significance at 10%, 5% and 1%, respectively. Panel A shows the 36 BHARs for the RTO and matched IPO samples in both the Main and AIM markets. Panel B and C report the BHARs for all IPOs and RTOs listed in each of the two markets respectively. And panel D reports performance for each of the three RTO types separately.

Panel A: RTOs and matched IPO sample

	Matched IPOs				RTOs			
	Month 6	**Month 12**	**Month 24**	**Month 36**	**Month 6**	**Month 12**	**Month 24**	**Month 36**
EW	-4.56%	-14.71%**	-21.77%***	-34.34%***	-7.35%**	-12.25%**	-17.14%*	-13.15%
T-test	-0.73	-2.18	-2.10	-3.83	-2.14	-2.19	-1.83	-0.84
VW	-5.45%*	-3.08%	-9.84%	-4.99%	-7.80%**	-21.65%***	-33.40%***	-30.64%**
T-test	-1.92	-0.48	0.72	0.43	-2.36	-3.03	-3.24	-2.39
No. Observations	233	228	210	186	237	232	212	180

Panel B: Matched IPO Main and AIM

	Matched MAIN IPOs				Matched AIM IPOs			
	Month 6	**Month 12**	**Month 24**	**Month 36**	**Month 6**	**Month 12**	**Month 24**	**Month 36**
EW	2.71%	-0.94%	79.79%*	50.82%	-5.28%	-16.11%**	-31.88%***	-42.35%***
T-test	0.28	-0.03	1.73*	1.44	-0.76	-2.15	-4.36	-5.16
VW	-3.26%	7.02%	55.99%**	41.18%**	-7.08%	-11.13%	-26.13%***	-27.67%***

T-test	-1.30	0.64	2.07	2.10	-1.54	-1.50	-3.47	-2.87
No. Observations	21	21	19	16	212	207	191	170

Table 4.7-A (panel C) provides further support for the size differences in the performance of RTOs by showing the separate buy and hold results for the RTOs listed in Main and AIM markets. Consistent with our previous results, this section demonstrates that the overall negative performance of RTOs is predominantly due to such issues listed in the AIM market. At the same, although the BHAR is negative and statistically significant for RTOs listed on AIM, the results for value weighted is similar for RTOs listed on Main market but not statistically significant. At the same time equal weighted BHARs for RTOs both in Main and AIM markets perform better that their value weighted counterparts.[1]

Panel C: Matched RTO Main and AIM

	RTO MAIN				RTO AIM			
	Month 6	**Month 12**	**Month 24**	**Month 36**	**Month 6**	**Month 12**	**Month 24**	**Month 36**
	-0.01%	11.08%	16.07%	40.37%	-8.46%**	-15.72%***	-22.19%**	-22.18%
T-test	-0.05	0.70	0.78	1.31	-2.25	-2.87	-2.07	-1.17
VW	-4.04%	-24.76%*	-35.51%*	-27.11%	-10.80%**	-19.15%***	-31.56%***	-33.83%***
T-test	-0.95	-1.73	-1.80	-1.09	-2.20	-3.64	-4.15	-3.60
No. Observations	31	30	28	26	206	202	184	154

Finally Table 4.7-A (Panel D) reports equivalent performance estimates for Mature Shells, SPACs and Synergy RTOs separately. By the end of the 36-month period, SPACs and Mature Shells underperform their relative benchmarks in value-weighted terms by *63.77% and 32.59%*, respectively; the equivalent BHAR for Synergy RTOs is also negative at *-23.58%*, but not statistically significant. Such differences are consistent with the nature and motivation of the tree RTO groups.

Panel D: Three RTO groups

	Mature Shells				SPACs				Synergy RTOs			
	Month 6	**Month 12**	**Month 24**	**Month 36**	**Month 6**	**Month 12**	**Month 24**	**Month 36**	**Month 6**	**Month 12**	**Month 24**	**Month 36**
EW	-3.29%	-2.23%	-3.81%	-28.31%	-16.53%**	-22.77%**	-42.76%***	-49.29%**	-3.15%	-9.28%	-7.13%	-10.67%
T-test	-0.35	-0.06	-0.10	-1.47	-2.55	-2.21	-3.05	-2.02	-0.66	-1.39	-0.53	-0.59
VW	-9.89%	-15.83%	-20.28%	-32.59%*	-23.63%***	-29.14%***	-52.44%***	-63.77%***	-3.97%	-20.77%**	-30.84%**	-23.58%
T-test	-1.12	-0.96	-0.84	-1.79	-3.74	-3.53	-4.98	-4.85	-0.97	-2.26	-2.34	-1.44

No. Observations	41	40	37	30	74	72	63	52	122	120	112	98

To provide some further insights into the nature and drivers of the differences in the aftermarket between the three RTO groups, Table 4.7-B reports multivariate regression results using 36-month equally-weighted buy-and-hold returns as the dependent variable. We control for company size at the time of the listing by using the listing market, i.e. Main or AIM, and industry by using dummies for Technology and Consumer Services.[1] We use return on assets as an indicator of operating performance and the premium/discount on investment trusts during the three-month period before the public listing as an indicator of market sentiment. Model 1 shows the regression results for both the IPOs and RTOs. The positive and significant coefficient for the IPO/RTO dummy suggests that RTOs perform relatively better than their IPO counterparts, although the BHARs for both groups at month 36 are negative. Unsurprisingly, we also observe a positive and significant coefficient for return on assets across all six models, confirming the strong relationship between market and profitability. It is also interesting to note the negative and significant coefficients for market sentiment in Models 1, 3 and 4 as they are consistent with the view that RTOs offer a relatively easy method of public listing during adverse market conditions.

Finally, in Models 4 to 6 we examine the 36-month aftermarket across the three RTO groups controlling again for the listing market and industry. The negative and significant coefficient for SPACs indicates that their performance is worse than the other two groups; on the other hand, Synergy RTOs, in spite of their negative BHARs by the end of the 36-month period, still do relatively better than the other two groups.

Table 4.7-B: Multivariate cross-sectional regressions of 36-month aftermarket performance of

The dependent variable is the equally weighted BHAR for RTOs and Matched IPOs relative to the FTSE All-Share Index or the FTSE SmallCap Index as the market benchmark. The independent variables are: a dummy variable with the value 1 for *RTOs* and 0 for *IPOs*; the LSE listing market equal to 1 for *Main* and 0 for *AIM*; *return on assets* (EBITDA/assets) at the time of the listing; and industry dummies for *Consumer Services* and *Technology* (which represent a significant proportion of the sample: 24% and 13% of the total population of RTOs respectively); *market sentiment* is proxied by the premium/discount of investment trusts during the three-month period before listing. *, ** and *** indicate significance at 10%, 5% and 1%, respectively.

	All (1)	**Matched IPOs (2)**	**All RTOs (3)**	**Mature Shells (4)**	**SPACs (5)**	**Synergy RTOs (6)**
RTO (1)/IPO (0)	0.119* (0.82)					
Main (1)/AIM (0)	0.493** (2.27)	0.298* (1.67)	0.881** (2.30)	0.888** (2.31)	0.771** (1.92)	0.785** (1.99)
Return on assets	0.0051* (2.35)	0.004* (1.76)	0.006*** (3.37)	0.005*** (3.19)	0.003* (1.78)	0.003*** (2.26)
Market sentiment	-0.025 (-1.03)	-0.010 (-0.42)	-0.049* (1.57)	-0.051* (-1.57)	-0.041 (-1.32)	-0.047 (-1.44)
Technology	-0.422** (-2.07)	-0.332* (-1.76)	-0.577** (-2.31)	-0.560** (-2.31)	-0.611*** (2.39)	-0.577** (-2.29)

Consumer Services	-0.408** (-2.34)	-0.289* (-1.77)	-0.487** (-1.88)	-0.461*** (-1.84	-0.546** (-1.94)	-0.492** (-1.90)
Mature Shells				-0.187 (-0.83)		
SPACs					-0.388* (-1.58)	
Synergy RTOs						0.395* (1.65)
Intercept	-0.379* (-1.90)	-0.294* (-1.66)	-0.431** (-2.35)	-0.433*** (-2.36)	-0.222 (-1.02)	-0.619*** (-2.69)
R2 adjusted	0.026	0.012	0.038	0.067	0.074	0.078
No. Observations	359	184	177	177	177	177

4.8. Conclusions

Despite the potential benefits and recent growth, RTOs have attracted considerable adverse publicity and regulatory attention. The similarity of the IPO and RTO regulatory frameworks in the UK in terms of transparency, disclosures and shareholder approvals provide a unique opportunity to assess the potential implications of such consistency on the characteristics, motivation, follow-on corporate activity and aftermarket performance of the two groups of listings during their first three years of going public.

Using a sample of 243 Reverse Takeovers (RTOs) and a matched sample of IPOs listed on the London Stock Exchange during the period January 1995 to June 2012, we find that under the broad RTO definition, there are three groups of firms which differ in terms of the characteristics, maturity stage of the public and/or private parties involved and the underlying motivation for going public via the RTO route. In contrast to the US experience, we show that the majority of UK RTOs consist of firms looking for expansion through a simultaneous synergetic acquisition and a public listing, with the remaining reversing into some type of listed shell entity. We also find that, consistent with the pattern of IPOs, firms choosing the RTO route to go public are also actively involved in acquisitions, SEOs or both soon after their public listing and remain active during the whole three-year period in the aftermarket. The survival rate of RTOs (excluding takeovers as a reason for delisting) is only marginally lower than IPOs (90%), ranging from 77% to 85%, depending on the type of RTO. Thus, the UK evidence suggests that, although an RTO is a quite distinct method of going public and the profiles of the companies involved are different from ordinary IPOs in terms of financial characteristics at the time of their public listing, their survival rates and aftermarket performance are very similar. In fact, the apparent long-term underperformance in value-weighted terms for the RTO group as a whole is predominantly due to a relatively small number of large SPAC RTOs. Our evidence suggests that the transparency and strictness of the regulatory framework make RTOs a viable alternative for a range of small companies aiming for a public listing. In other words it could be argued that the bad reputation of RTOs in US is not necessarily related to the nature of transaction itself but more to the opacity and complexity of the RTO process. Moreover, the transparency and strictness of the regime also has a direct impact on the motivation for going public.

Although our results are consistent with the view that the disclosure and transparency of the regulatory framework, by lowering information asymmetry, providing additional protection to investors and reducing mispricing, account for at least part of the positive assessment of UK RTOs, it will require further research to establish with certainty the exact reasons for the performance differences between the UK and the US. In that sense, our results come as a timely contribution to on-going discussions across different countries regarding the regulations governing this type of transaction.

4.9. Appendix: The RTO regulatory frameworks in the UK and the US

There are a number of important differences between the UK and the US in terms of the regulatory requirements related to the definition of an RTO, shareholder approval, required documentation and capital raising practices.

First, according to the UK Listing Authority (UKLA) guidelines, an RTO on the AIM market is defined as any acquisition or acquisitions in a 12-month period which exceed 100% in any of the class tests for a company listed on AIM; these tests are set in terms of gross assets, profit, turnover and amount paid in relation to the target's market value. Second, in terms of shareholder approval and disclosure requirements, RTOs are treated in exactly the same way as IPOs.[1] Third, UKLA guidelines require that any agreement, which would result in a reverse takeover must be conditional on the consent of its shareholders. In the US, shareholder approval depends on the shell company's status of incorporation and listing; many states and stock exchanges require shareholder approval before a company can issue shares constituting more than 20% of the outstanding shares pre-transaction.[1,]

Fourth, UK RTOs often raise capital at the time of such transactions, similar to Australia where the raising of capital from RTOs occurs in the large majority of cases (Brown *et al*., 2012). In the US, on the other hand, the concurrent raising of capital happens rarely; some private companies, however, may combine a reverse merger with a private investment in a public equity (Asquith and Rock, 2011). The new entity may, of course, access capital markets at a later date when the stock has risen and the offering becomes less dilutive. This is broadly similar to the two-stage listing process available through Introductions on the London Stock Exchange (LSE). In terms of regulatory and institutional details, an Introduction is identical to an IPO except that no shares are introduced, hence no money is raised.

Fifth, an RTO company seeking readmission to the LSE needs to comply with exactly the same entry requirements as any other company applying for admission for the first time, including the publication of a prospectus and full accounting disclosures. The prospectus always refers to such readmissions as reverse takeovers if they are classified as such under UKLA guidelines. In such cases, they will have to fulfil various class tests as RTOs on the LSE. Applying the same entry requirements as IPOs and requiring the publication of a prospectus lowers information asymmetry, reduces mispricing and enhances the market's confidence in the performance of the newly listed firms.

In the US, since the exchange of shares between the two parties is considered to be an offer of securities all that is required is for the shell company to prepare and circulate a private placement memorandum describing the terms of the deal as well as some information about themselves. This may be not necessary if the shareholders of the private company qualify as accredited investors.

Last but not least, while it appears that the majority of US RTOs (RMs) involve shell companies[1] which are in this situation either as a result of termination of their normal operations or because they were formed explicitly as a public shell,[1] UK RTOs do not necessarily involve strictly defined shell

companies either in terms of SPACs or not operating as a result of recent restructuring, but do include a wider variety of listed entities as bidders.

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Chapter 3

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